No. 12506

United States
Court of Appeals
for the Ninth Circuit.

WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. duP. BAYARD, Receiver,

Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY, DEEP CREEK RAIROAD COMPANY, THE WESTERN REALTY COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and DELTA FINANCE CO., LTD.,

Appellees.

MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE & CO., INC.,

Appellants,

vs.

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Transcript of Record
In Five Volumes

Volume III
(Pages 911 to 1361)

Appeals from the United States District Court, Northern District of California, Southern Division.

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Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

PAUL P. O'BRIEN, CLERK

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Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

ROBERT BUCHANAN

called as a witness on behalf of the plaintiff, sworn.

The Clerk: Will you state your name to the Court, please?

A. Robert Buchanan.

Direct Examination

By Mr. Phleger:

Q. Mr. Buchanan, where do you live?

A. I live at 2306 Leavenworth Street, San Francisco.

Q. What is your occupation? [663]

A. I am a certified public accountant.

Q. With what firm are you associated?

A. Lybrand, Ross Bros. & Montgomery.

Q. How long have you been associated with that firm? A. About 25 years.

Q. What has been your experience in the field of accountancy?

A. Well, I have been with that firm of certified public accountants, and for that period of time. In fact, a somewhat longer time than that. In that time I have been the manager of the tax department in San Francisco.

Q. For how long have you been manager of Lybrand's tax department in San Francisco?

A. Approximately 25 years.

Q. Are you licensed to practice before the Treasury Department? A. Yes, sir.

Q. Have you testified before as an expert in court on tax matters? A. I have.

(Testimony of Robert Buchanan.)

Mr. Phleger: Before proceeding further with the examination of this witness, your Honor, I would like to offer in evidence certain documents bearing upon this particular matter, before proceeding with the specific questions.

I would first offer in evidence the following sheets, which are identified by the following designations: Interveners' 128A, 128B, 128C, 128D, 128E, 128F, and Interveners' 85A. [664] Those, may it please the Court, are computations which I am sure counsel will stipulate were prepared by Mr. Reilly of the Coulson firm.

Mr. MacKinnon: Mr. Reilly is not in the Coulson firm; never has been.

Mr. Phleger: Will you stipulate that he was employed and paid for by the Coulson firm in connection with the preparation of these tax returns?

Mr. Adams: No, I think that that is an inaccurate statement of Mr. Reilly's position. His charges are taken up in the bill you have seen, and those charges were paid by the railroad company.

Mr. Phleger: Well then, we will make it more specific, since you won't help me; and that is that Mr. Reilly was employed in and about the preparation of these returns, under the direction of Mr. Polk, that his current salary was paid by the Coulson firm, but the Coulson firm has now billed the railroad company for the amounts paid by it to Mr. Reilly.

(Testimony of Robert Buchanan.)

Mr. Adams: Mr. Phleger, and your Honor, there is no purpose to have anything but an accurate statement here, and I am sure that is what we all want. Now Mr. Reilly was in the employ of Consolidated Edison. He did some special work as an accountant in connection with this matter. I am a little troubled by being asked for statements that frankly, just from my own recollection, I cannot be sure are accurate in detail. [665] Mr. Reilly's position in the matter has been developed here. He worked in the office of the plaintiff corporation as an accountant.

Mr. Phleger: On these tax matters?

Mr. Adams: These tax matters.

Mr. Phleger: Right. And these are sheets prepared by him.

Mr. Adams: That is my recollection.

Mr. Phleger: Without going into them more—in fact I won't go into them further, other than to state that these were computations made in the fall of 1946 at the request of Mr. Polk, as to what the taxes would have been in this matter had the returns not utilized the stock loss.

I will offer that as Plaintiff's Exhibit 73.

(Intervener's Exhibits 128A through F, inclusive, and Interveners' 85A, referred to above, were received in evidence and marked Plaintiff's Exhibit 73.)

Mr. Phleger: I will now offer as Plaintiff's Exhibit 74, three sheets otherwise identified as Inter-

(Testimony of Robert Buchanan.)

vener's 114A, 114B, and 114C, consisting of a letter on the letterhead of the Western Pacific Railroad Company, dated November 8, 1943, addressed to Mr. James K. Polk, New York, by Mr. D. C. DeGraff, general auditor of the Western Pacific Railroad Company, showing the amounts that were being accrued on the books of the defendant corporation for 1943 taxes and the estimate of the total amount for that year. [666]

Mr. Clark: On a consolidated basis, isn't that right?

Mr. Phleger: That is correct; on the way that they were actually accrued for the period up to that date, and estimated for the balance of the year.

Mr. Clark: And without reference to any use of the stock loss. [666A]

Mr. Phleger: Correct.

(Letter dated November 8, 1943, from DeGraff to Polk, was received in evidence and marked Plaintiff's Exhibit 74.)

Mr. Phleger: I will now offer as Plaintiff's Exhibit 75 two sheets otherwise identified as Railroad Company's Exhibits 898 and 898-A, consisting of a letter signed by Mr. Charles Elsey, directed to Mr. Robert E. Coulson, dated November 13, 1943, giving an estimate of the income of the railroad for the current year, 1943, and containing the following statement:

"Please note that these statements are on the basis of estimated Federal taxes in the amount of

(Testimony of Robert Buchanan.)

$8,274,000, which have been calculated as set forth in detail on a statement submitted by Mr. DeGraff to Mr. Polk by letter dated November 8, 1943."

(Letter dated November 13, 1943, from Elsey to Coulson, was received in evidence and marked Plaintiff's Exhibit 75.)

Mr. Phleger: I will now offer as Plaintiff's Exhibit 76 the following sheets, identified as follows: Interveners' 455-A, 455-B, 455-C and 455-D.

These, may it please the Court, are the journal entries on the books of the defendant corporation, showing on the top sheet, 455-A, the reversal of the accruals for the Federal income taxes for the year 1943, in the amount of $7,069,052. The second sheet, 455-B, shows the accrual in the month of [667] January, 1944, of railway tax accruals—no, strike that—of United States Government Federal income taxes in the amount of $893,000. It shows on the next sheet the accrual for March, 1944, of United States Government Federal income taxes, in the amount of $932,300. On 455-D the accrual of U. S. Government Federal income taxes shows in the sum of $1,282,700.

(Interveners' Exhibits 455-A through -D, inclusive, were received in evidence and marked Plaintiff's Exhibit 76.)

Mr. Phleger: Will it be stipulated, Mr. Adams, that the accruals just mentioned for the year 1944, January to March, were on a consolidated basis but

(Testimony of Robert Buchanan.)

not including the plaintiff corporation; namely, a consolidated basis with the railroad company as the top corporation?

Mr. Adams: That is my understanding.

Mr. Phleger: In other words, the returns for the first four months, as shown by the books, did not include the consolidation which later was used in the returns for the first four months of '44?

Mr. Adams: I think that is an inadventent statement; if you were to hear it read, you would find you started it out, "In other words, the returns for the first four months"—what you had in mind was that the accruals during the first four months of the year 1944 as entered upon the accrual books did not include anything on account of the plaintiff corporation or its loss. [668]

Mr. Phleger: Yes. It was not on a consolidated basis, including the plaintiff corporation.

Mr. Adams: That is right.

Mr. Phleger: Contrary to the returns which were later filed, which did include a consolidation with the parent corporation.

Mr. Adams: Yes. And may it be stipulated that the books of accrual were adjusted before the end of the year in conformity with the returns as filed?

Mr. Phleger: I will so stipulate.

I will now offer as Plaintiff's Exhibit 77-A a copy of the corporation income and declared value excess profits tax return of the Western Pacific Railroad Corporation, and affiliated corporations,

(Testimony of Robert Buchanan.)

for the year 1940, and as 77-B the excess profits tax return of the Western Pacific Railroad Corporation for the same year, 1940.

Mr. Adams: Those are for the corporation, are they not?

Mr. Phleger: For the corporation and affiliated companies.

Mr. Adams: Yes.

(Corporation income declared value excess profits tax return for Western Pacific Railroad Corporation, 1940, and excess profits tax return of Western Pacific Railroad Corporation, 1940, referred to above, were received in evidence and marked Plaintiff's Exhibits 77-A and 77-B.)

Mr. Phleger: Those, may it please the Court, are required as a foundation for some estimates which we will shortly offer. [669]

I will now offer as Plaintiff's Exhibit 78-A the corporation income and declared value excess profits tax return of the Western Pacific Railroad Corporation and affiliated companies for the year 1941 as Plaintiff's Exhibit 78-B the corporation excess profits tax return of the Western Pacific Railroad Corporation and affiliated companies for the year 1941.

(The documents referred to were received in evidence and marked Plaintiff's Exhibits 78-A and 78-B.)

(Testimony of Robert Buchanan.)

Mr. Phleger: I will now offer as Plaintiff's Exhibit 79-A the corporation income and declared value excess profits tax return of the Western Pacific Railroad Company and affiliated companies for the period beginning May 1, 1944, and ending December 31, 1945. May it please the Court, that is the return of the defendant and its affiliated corporations for the last eight months of 1944. The return, as you will recall, for the first four months of that year, was a return of the plaintiff corporation and the defendant corporation and its subsidiaries, and for the plaintiff corporation for the entire year. In other words, the consolidation with the defendant was only for the first four months, these being the separate returns of the defendant corporation and its affiliated corporations for the last eight months.

Mr. Adams: Those last eight months, Mr. Phleger, being the last eight months of the operations of the court's trustees. That is correct, is it not?

Mr. Clark: That is true, 1944.

Mr. Phleger: Well, I think that is true. The dates speak [670] for themselves.

(Corporation income and declared value excess profits tax return of Western Pacific Railroad Company and affiliated companies, May 1, 1944, to December 31, 1945, was received in evidence and marked Plaintiff's Exhibit 79-A.)

(Testimony of Robert Buchanan.)

Mr. Phleger: The returns are signed by Mr. Elsey as president of the company.

I offer next as Plaintiff's Exhibit 79-B the excess profits tax return of the Western Pacific Railroad Company and affiliated companies, also for the last eight months of 1944.

(Excess profits tax return of Western Pacific Railroad Company and affiliated companies for last eight months of 1944 was received in evidence and marked Plaintiff's Exhibit 79-B.)

Mr. Phleger: I will now offer for identification Plaintiff's Exhibit 80, consisting of three sheets. Copies of this, may it please the Court, have already been given to counsel. I ask that this be marked for identification. You might desire to follow this. Will you give that to the Court?

(Copy of document handed to Court through clerk.)

Mr. Phleger: The exhibit consists of three sheets headed, respectively, "Basis 1," "Basis 2," and "Basis 3."

(The sheets referred to were marked Plaintiff's Exhibit 80 for Identification.)

Q. (By Mr. Phleger): Mr. Buchanan, I direct your attention to Plaintiff's Exhibit 80 for Identification (handing to witness), [671] and will ask you if you prepared this exhibit. A. I did.

Q. Did you prepare it at the request of attorneys for the plaintiff? A. I did.

(Testimony of Robert Buchanan.)

Q. And pursuant to their instructions?

A. I did.

Q. I direct your attention now to the first page of the exhibit, entitled "Basis 1," and to the heading reading, "The Western Pacific Railroad Corporation and its Affiliates, Federal Income Taxes and Excess Profits Taxes, on a Separate Return Basis, Using the Data as Actually Shown in Consolidated Returns Filed."

Will you please state to the Court how this basis 1 was prepared and what is shows.

A. May I have access to my working papers?

The Court: Yes.

Mr. Phleger: Yes, you may.

(Witness produces papers.)

The Court: This witness is testifying as to what the income taxes would have been had separate returns been filed?

Mr. Phleger: Exactly.

The Court: All right.

A. These exhibits were prepared, using as the basic material the returns or photostatic copies that were furnished to me by Mr. Phleger. The returns of the—— [672]

Mr. Phleger: Just a moment. It will be stipulated—or perhaps I had better have Plaintiff's Exhibit 3, 4 and 5, the tax returns.

(Documents handed to counsel by the clerk.)

Q. (By Mr. Phleger): I show you, Mr.

(Testimony of Robert Buchanan.)

Buchanan, Plaintiff's Exhibits 3-A, 3-B, 4-A, 4-B, 5-A and 5-B (handing to witness), and I ask you if those are the returns or copies of them which you used in the computation you have just referred to.

A. These returns, plus the returns for 1940 and '41.

Q. Those are the ones which were just introduced in evidence? A. That is correct.

Q. As Plaintiff's Exhibit 77, 78 and 79?

A. That is correct.

Mr. Adams: The witness has not mentioned 79. You may wish to ask him about 79.

Mr. Phleger: 79 is the last eight months.

Mr. Clark: Of '44.

Mr. Phleger: He did use that.

The Witness: Yes, '44.

Q. (By Mr. Phleger): Will you now proceed.

A. Now, the material found in those returns are the basic material on which these computations were made, and in which it was determined on Basis 1 that on a separate return basis there would have been a tax payable by these companies aggregating $21,622,358.71. [673]

The same material—that is, the material contained in the returns—was used in computing the tax shown on Basis 2. The difference between the two—that is, between Basis 1 and Basis 2—being primarily the carry-forward of certain net operating loss carry-overs and unused excess profit credit carry-overs.

(Testimony of Robert Buchanan.)

Q. Will you refer, Mr. Buchanan, to the title of Basis 2 and state from it or your recollection of the specific method in which this was prepared.

A. Well, the title is "The Federal Income and Excess Profits Taxes on a Separate Return Basis, Using the Data as Actually Shown in the Consolidated Returns Filed, and Giving Each Affiliate the Benefit of Any Operating Loss Carry-over or Unused Excess Profits Credit Carry-over Attributable to It, Though Contrary to Regulations 110, Section 33.31(e) and (f)."

Q. And will you state what those regulations were?

A. Well, the regulations provided that for that type of loss or carry-over which had accrued prior to January 1, 1942, it could not be carried over to the separate returns of the individual companies if they made separate returns.

Q. And you therefore in this computation did not follow that regulation, but gave the separate companies the benefit of their own carry-over?

A. That is correct.

Q. Which otherwise they would have been deprived of had they filed [674] separate returns, because of having earlier filed consolidated returns?

Mr. MacKinnon: Just a moment. I object to that; that is a question of law for your Honor to decide, whether or not the regulations so provided. That is a question of law.

(Testimony of Robert Buchanan.)

Mr. Phleger: Well, I am asking him what he did.

Mr. MacKinnon: No, you were asking him for his opinion. That is the basis of my objection to the question.

The Court: Well, you are trying to find out from this witness whether or not his calculations were based upon that conclusion, is that it?

Mr. Phleger: That is correct. In short, may it please the Court——

The Court: If that is the question, I will overrule the objection.

Mr. Phleger: Will you read the question.

(Previous question read by the reporter.)

A. That is correct.

Mr. Phleger: I don't know whether I made my point clear to your Honor, but this was prepared under our instructions to give the benefit to the individual companies of privileges they would not actually have had.

The Court: This witness is of the opinion that they couldn't take this deduction, but that the calculations are based on the assumption that they could have taken it, is [675] that what you mean?

Mr. Phleger: Correct.

The Witness: That is correct, sir.

Q. (By Mr. Phleger): Now, I direct your attention to Basis 3.

The Court: That doesn't mean I am accepting the conclusion of law.

(Testimony of Robert Buchanan.)

Mr. MacKinnon: I understand, your Honor. I will say it is a question of law for your Honor to determine. [675-A]

Q. I direct your attention now to basis 3. Will you state what that shows, the basis on which it was prepared?

A. As stated in the heading, basis 3 was computed on the basis of a consolidated return or returns which were filed but excluding the corporation's stock loss of some $73,000,000.

Mr. Phleger: I will offer this now as Plaintiff's Exhibit, having been marked for identification previously.

(Plaintiff's Exhibit 80 for identification previously was thereupon received in evidence.)

Mr. Phleger: That is all.

Mr. Clark: No questions from us, your Honor.

Cross-Examination

By Mr. Adams:

Q. Mr. Buchanan, do I understand correctly that the figures and all the figures which you used in making these computations are figures to be found upon the income and excess profits tax returns for 1940, 1941, 1942, 1943, and 1944 for the parent corporation and likewise return of the Western Pacific Railroad Company and its affiliates as a consolidated return for the last eight months of the year 1944?

A. That is correct.

(Testimony of Robert Buchanan.)

Q. You did not go to any other source material whatever? A. No.

Q. Now, referring to basis 1, do I understand that basis 1 is your computation made up from the use of those figures and those returns of what the federal income and excess profits tax [676] liabilities of those companies shown on your schedule would have been if each of the companies had filed separate returns for the years 1942, 1943 and 1944?

A. If you will look at basis 1, you will see that the period is January 1 to April 30, 1944, so that when you say 1944 you are speaking of that period. That is what this basis 1 says. The reason I answer in that fashion is there might be some confusion because for the calendar year 1944 the parent corporation, that is, the Western Pacific Railroad Corporation, filed a consolidated return in which it included its income for the entire year and included the income of these subsidiaries for the four months' period, and then subsequently a consolidated return was filed for the last eight months of the calendar year 1944 by the Western Pacific Railroad Company and its subsidaries, but in this computation in basis 1 we refer to this period as the January 1 to April 30, 1944, period.

Q. Just to get my understand of this year, we refer only to the year 1942, referring to the figures computed on your basis 1, are the figures shown for that year your computation of what the tax liabilities of these several companies would have been had

(Testimony of Robert Buchanan.)

each of them filed separate returns for that year?

A. For the calendar year 1942.

Q. Based upon those figures you have taken from a consolidated return?

A. Based upon those figures taken from the consolidated return [677] for the calendar year 1942.

Q. Is the same thing true with regard to the year 1943, as shown on your schedule basis 1?

A. That is correct.

Q. Would you please explain to me how you calculated the figures under the column, "Period January 1 to April 30, 1944"?

A. I would like to refer to the return itself, if I may.

Q. Yes, you are privileged to do that, surely.

Mr. Phleger: Might I suggest to your Honor that perhaps if those papers were laid over on this desk——

The Court: Yes, he has room to lay them out there. The witness might testify from down to that table, if you will.

The Witness: Basis 1, the period January 1 to April 30, 1944: that was based on the income shown in the consolidated return for the Western Pacific Railroad Company and Corporation. Its income was included therein, and that was for the four-month period as stated at the top of the schedule called basis 1, Period January 1 to April 30, 1944, and that is based on the net income of the Western Pacific Railroad Company for that four-month pe-

(Testimony of Robert Buchanan.)

riod, included in the consolidated return that was filed for the Western Pacific Railroad Corporation and its affiliated companies for the calendar year 1944, showing a net income of $2,975,142.13, and this tax shown in basis 1 is on the basis of the Western Pacific Railroad Company filing a separate return showing that net income for that period.

Q. (By Mr. Adams): Is the same thing true, Mr. Buchanan, with respect to the smaller amounts for Tidewater Southern and Western Realty and Standard Realty and Development Company which are listed under that period on your basis 1?

A. That is correct.

Q. So where you obtained the figures entered in that column was to go to the corporation's consolidated returns for the year 1944, which included these first four months of 1944, and you obtained your income figures out of that return for this period? A. That is correct.

Q. And you made calculations of those income figures that you derived from that return?

A. That is correct.

Q. With regard to the columns for the years 1942 and 1943 on your basis 1 calculation, do I understand that in each of those cases you simply took the figures shown in the consolidated returns filed for each of those years as the income figures?

A. That is correct.

Q. And then you made tax calculations on the income figures taken directly from those returns?

A. That is correct.

(Testimony of Robert Buchanan.)

Q. It is not necessary for you to stand, Mr. Buchanan.

A. It is easier for me to find the figures in here if I stand. May I be permitted to stand?

The Court: Yes. [679]

Q. (By Mr. Adams): In your computations of them on basis 1, did you change any of the income or deduction figures found in those returns as filed in making up your estimates of tax liability on basis 1?

A. No. For example, the Western Pacific Railroad Company in the return I am looking at, the consolidated return for year ended December 31, 1944, the statement of income in the Western Pacific Railroad column shows a net income of $2,975,-142.13, and that is the figure I used in making these calculations that are shown on basis 1 on a separate return basis.

Q. Isn't that last figure that you just read a figure about the four-month period of 1944?

A. That is correct.

Q. I was speaking of the full calendar year, calculations shown on basis 1. A. Yes.

Q. Is it likewise true in those cases that you did not change any income or deduction figures shown on those returns in the making up of your tax computation? A. That is correct.

Q. Did you give any attention in making up your tax calculations on a separate return basis to the inter-company accounts between members of this group of affiliated corporations?

(Testimony of Robert Buchanan.)

A. Yes, I did. First, may I refer to a schedule I have of those inter-company accounts set up?

Q. Yes.

A. I prepared a schedule showing the inter-company interests. For example, in 1942 I have a schedule here which shows that the Western Pacific Railroad Corporation—it appears in the returns that there was interest on advances to the Western Pacific Railroad Company, interest advances to the Western Pacific Railroad Company, due the Western Pacific Railroad Corporation, of $274,733.10. The debtor company there was the Western Pacific Railroad Company. The creditor company was the Western Pacific Railroad Corporation. In preparing these returns the debtor company eliminated this deduction through what is known as schedule M, which on the tax return is a schedule which reconciles net income as shown by the return with a net income for the books.

Q. May I interrupt, Mr. Buchanan? You stated just now the debtor company in preparing this return. It is not your intent, of course, to give any testimony as to who prepared these returns or anything of that sort? You did not have that in mind?

A. No.

Q. What you did have in mind was it appears on the face of the returns that those things are so?

A. That is correct.

On the face of the returns it appears that the debtor company had deducted the interest, but that

(Testimony of Robert Buchanan.)

the creditor company had not taken it up as income. So in order to check that out, [681] and just see why that was, and to see the disparity had been corrected in the returns, so I wouldn't have to give effect to it in these computations, I made up the schedules to reconcile the fact that the debtor corporation—for example, in this example the Western Pacific Railroad Company—why it deducted $274,000 of interest due the parent company and the parent company had not taken it up as income. It was necessary to work this reconciliation out to make sure that it had been eliminated in these consolidated returns, and therefore it did not need to be adjusted in these computations, and those schedules that I have prepared here in detail show the mechanics by which they made this elimination, so it was not necessary to make any adjustment in these computations. It was by means of this schedule M attached to the returns, and on the other side the creditor corporation made the adjustment in the eliminations on the balance sheet; in other words, the creditor corporation eliminated the payable of the debtor company through the consolidated balance sheet, on which the amount due the affiliated companies was eliminated, and it is shown as an amount greater than due from the affiliated companies. So by that mechanics these adjustments that otherwise would have to be made, that is, the difference between the debtor corporation deducting the interest and the creditor

(Testimony of Robert Buchanan.)

corporation failing to take it up, was not necessary to be made. So I would answer your question that since that was eliminated in the consolidated returns, I did not [682] in making these computations, make any change in the final figures found in the consolidated return.

Q. In other words, you concluded that in calculating the tax liability of the Western Pacific Railroad Company on a separate return basis, you did not consider it necessary to restore the interest accrued on the books as a deduction?

A. That is correct, because the company itself had eliminated it in these consolidated returns.

Q. Of course, it is unnecessarily a part of consolidated return accounting to eliminate inter-company transactions; that is correct, is it not?

A. That is correct.

Q. Mr. Buchanan, are you familiar with the rulings of the Treasury Department generally to the effect that while these railroads were in reorganization their tax returns would take into account the old debt structure until reorganization was completed?

A. I think that is a legal question, Mr. Adams, that I would not——

Q. I was asking you if you were familiar with it.

A. In what respect?

Q. Did you know about that?

A. Would you repeat that question?

(Question read.)

A. No, I am not familiar with that. [683]

(Testimony of Robert Buchanan.)

The Court: If separate returns had been filed in the first instance, would the net income have been shown differently than it was in this consolidated return?

A. No.

Q. You said a moment ago that these credits and debits between the companies you took just from the income as shown in the consolidated returns? A. Yes.

Q. Suppose they had filed separate returns; would your calculation of that income have been just the same?

A. I think it would because the omission of the income from the income of the parent corporation might well have been—that income might well have been omitted on the ground it was not collectible.

Q. (By Mr. Adams): What about the debtor corporation, the one that had the interest to pay?

A. That might have been affected by the fact that it was in reorganization.

Q. And so to a measure, Mr. Buchanan, it might be affected by the Treasury rulings that I have just referred to?

A. That is possible.

Q. You do not know about that?

A. I am not familiar with that phase. [684]

* * *

Q. (By Mr. Adams): Mr. Buchanan, referring to your Basis 1 computations, did you make any allowance for net operating loss carry-overs of any

(Testimony of Robert Buchanan.)

of these companies? A. Not in Basis 1.

Q. You made no such allowance for net operating loss carry-overs for the years prior to 1942?

A. That is correct; I did not on Basis 1.

Q. On Basis 1? A. But on Basis 2 I did.

Q. Yes. Now, speaking of Basis 1, I take it neither did you make any allowance for net operating loss carry-overs from year to year within the period covered by Basis 1?

A. That is correct.

Q. Now, still referring to Basis 1, did you make any allowance for carry-overs of unused excess profits credits? A. No.

Q. Neither for the years prior to 1942?

A. That is correct.

Q. And similarly, you did not make any such allowance for carry-overs of unused profits credits from year to year within the period covered by the Basis 1? [685] A. That is correct.

Q. Now, in your computations on Basis 1, did you give any effect to any deductions which might have been claimed by the Western Pacific Railroad Company on account of a partial write-down of advances and loans made to the Sacramento Northern Railway? A. No.

Q. Now, if a deduction of that sort—that is to say, a deduction on account of a partial write-down of the value of such advances to the Sacramento Northern Railway—had been claimed in 1943, and if it had been allowed by the Treasury Department,

(Testimony of Robert Buchanan.)

would that bring about a difference in the computations of tax liability from those which you have made in your Basis 1?

A. I would have to investigate what the basis was of the assets which you say might have been written down. Not having that information, I don't recall that that information appears in the returns.

Q. Let me put the question this way: If the Treasury Department had allowed in a separate return for the year 1943 a deduction for a partial bad debt loss on account of the Sacramento Northern Railway's indebtedness, in an amount, say, of $8,500,000, would that affect the computations which you have made in your Basis 1?

Mr. Phleger: Just a moment. I don't want to interfere with this cross-examination, but this question is simply, "If [686] deductions had been claimed which were not claimed, and had they been allowed, would it have reduced the taxes?" Well, obviously it would; and I don't see what is gained by asking this witness if it would. We will stipulate that if they had had these losses, which were in fact claimed, and that if they had been allowed, there would have been less taxes. But they weren't claimed, they weren't allowed, and these are the taxes which are shown by this computation to have been payable had separate returns been filed.

The Court: Mr. Adams, may I ask you something so that I may understand this question? Is it going

(Testimony of Robert Buchanan.)

to be your contention that had a separate return been filed for the company, there were other deductions which could have been made, but which were not made because this loss was so large that they didn't even make any other?

Mr. Adams: That is just about right, your Honor. I think I could say "Yes" to that without any qualification, but I would like to add one further item to that, referring to this particular deduction: that is, the deduction for a partial bad debt loss. Such a deduction was not available under the laws and regulations, if you filed consolidated returns. It was available, it will be part of our case to show when we get to our defenses, that it was available if you filed a separate return.

The Court: Well, of course, this witness has only testified to the fact that he had taken the data that he found on the [687] consolidated return, and using the information there as to income, he has calculated that, absent the deduction for the stock loss, what the tax would have been.

Mr. Adams: Yes, your Honor.

The Court: That is the extent of this witness' testimony.

Mr. Adams: And he has testified that the sole source, the sole basis, for his computations was the figures that were shown in the consolidated returns as filed.

Q. (By Mr. Adams): Is that correct?

A. That is correct. [688]

(Testimony of Robert Buchanan.)

Mr. Adams: Now, I have two or three other questions. Perhaps it will be self-evident, but if I may have your Honor's patience I will go through with that.

Q. Mr. Buchanan, if the income for the year 1943 of the Western Pacific Railroad Company were to be adjusted by deduction for cut-backs in refunds to the United States government of, say, a million and a half dollars in that year, I take it that such an adjustment would materially reduce the computations of tax liability that you have paid?

A. Yes.

Q. And you yourself——

Mr. Phleger: May I again point out the witness has stated what he did. Now, these are hypothetical questions that if they had done something which they did not do, would the tax be less. If their income was less, would the tax have been less. Of course it would have been. That is not what he testified to.

The Court: Mr. Adams has stated he has two or three questions he wants to ask along that line. It is obvious what the answer is, but you may ask the question.

Mr. Adams: I think so, but of course, the same thing would be true for the years 1942 and for the first four months of 1944?

The Witness: That is correct.

Q. (By Mr. Adams): And it is likewise the fact, is it not, Mr. Buchanan, that if in the years

(Testimony of Robert Buchanan.)

1942, 1943 and the first four months of 1944 a different treatment had been given to accelerate am amortization of the emergency facilities, then different results would flow from what are shown on your Basis 1 statement?

A. That is correct.

Q. And you have made no calculation of that sort?

A. I have made a computation to see about what that difference would be.

Q. You have? A. Yes.

Q. Will you please state what it is?

Mr. Phleger: I point out that this is not cross-examination. If he wants to ask this witness the questions as his witness, it is all right with us.

Mr. Adams: I think it is cross-examination upon the scope and limitations of his own work. That is the object of these questions.

The Court: I do not pay much attention to whether the facts are listed on the cross-examination or direct examination any more, anyhow. You mean the old rule that you are bound by the testimony of the witness?

Mr. Phleger: Right.

Q. (By Mr. Adams): Do you have the question in mind? A. Yes, I have.

Q. Go right ahead.

A. According to my computations—first let me say that these computations are based upon the principle of accelerating the [690] amortization,

(Testimony of Robert Buchanan.)

that is, shortening the amortization, which you are permitted to do under the law, due to the earlier termination of the war. You see, the amortization originally was figured on a six-year basis and then the war ended sooner than that time and we were permitted to shorten the amortization, and according to my computations, in 1942 that would have reduced the tax dollars $47,000; in 1943, $165,000; and in 1944, $482,000 in round figures.

Q. (By Mr. Phleger): You mean for the four months' period in 1942? A. Yes.

Mr. Adams: You have made the computations that you have just described on the assumption that the election was not taken to accelerate the amortization of the emergency facilities?

A. That is correct.

Q. Whereas under the consolidated returns as filed, is it the fact that, according to your understanding, the election was exercised to take advantage of the privilege of accelerating the mortization of those facilities? A. No, it would not.

Q. Oh, it was the other way around?

A. It was the other way around.

Q. In other words, this additional increase that you have just given us are predicated on the hypothesis that the election was exercised to accelerate?

A. No, it was not exercised.

Q. The election was exercised to allow it over the five-year period?

A. To allow it over the five-year period.

(Testimony of Robert Buchanan.)

Q. And that would have the tendency, as you compute it, to reduce the figures shown upon your Basis 1?

A. No, the other way around. In other words, if they had elected to shorten the amortization period, that would have increased their deduction and that, of course, would have reduced the tax shown here.

Q. The figures you have given me for these three years are deductions upon your figures shown on that basis 1? A. That is right.

Q. That would have been occasioned had they elected to accelerate? A. That's right.

Q. Mr. Buchanan, have you heard about the pending litigation between the government and the Class I carriers where the government seeks by way of reparations to recover portions of the war income of the railroads?

A. Have I heard anything about it?

Q. Yes.

A. Only what I read in the newspapers.

Q. And, I take it, your figures on Basis 1, Basis 2 and Basis 3 take no account of any possible recovery against the Western Pacific in such litigation? [692] A. That is correct.

Q. But may I direct your attention to the column for the year 1942 in your Basis 1, and referring to that, and particularly to the figures entered in that column, the Western Pacific Railroad, would you state what amount of taxable net income you used in computing the taxes entered there?

A. Yes. You are asking now for the year 1942?

(Testimony of Robert Buchanan.)

Q. Right.

A. Taxable net income as shown in the consolidated return for 1942 of $10,806,257.38, increased by the operating loss carry-over for 1940, which was shown in the return as $438,280.24, which increased the income by that amount to $11,244,537.62. You see, the Basis 1 is computed without any carry-over, so we added back carry-over that had been taken in the return itself.

Q. So the income figure that you used as Basis 1 in the year 1942 for the Western Pacific was made by adding to the income reported for the company in that return the carry-over of net operating loss for 1940 of $438,000?

A. That is right.

Q. Did you follow this same operation as far as the figures for 1943 and the first four months of 1944 are concerned? A. Yes, sir.

Q. Returning still to the year 1942 and the railroad company's figures, what was the amount of the excess profits net income which you used in your calculations? [693]

A. Going back to that figure that I gave you a little while ago as to the income of $11,244,537.662, that is the normal tax net income. I added to that 50% of the interest or borrowed capital in the amount of $1,361,259.44 and deducted a dividends received credit of $30, bringing the excess profits net income to $12,603,767.06. Does that answer your question?

Q. You understand that it does, do you not?

(Testimony of Robert Buchanan.)

The question was, What was the amount of the excess profits net income which you used in your computations?

A. Finally it comes down to $12,605,767.06.

Q. What was the amount of the excess profits credit which you used in computing the excess profits tax of the Western Pacific Railroad Company for the year 1942?

A. A specific exemption of $5,000 and an excess profits credit based on invested capital of $6,781,515.17.

Q. You state that last figure was based on invested capital? A. Invested capital.

Q. Where did you obtain the figure of invested capital upon which you based that amount?

A. From the return, that is shown in Schedule C, taxed to the excess profits tax return, consolidated return, for the calendar year 1942, and that is the schedule that shows the equity invested capital and the borrowed invested capital of all of the companies, and in the column for Western Pacific Railroad Company, starting out with an equity invested capital of [694] $75,800,000 and an average borrowed capital of $73,597,000, the schedule in line 36 finally arrives at $110,525,252.87. [694A]

And to that figure we apply the rates then in effect, of 8 per cent on the first 5,000,000, which is $400,000. 7 per cent on the next 5,000,000 is $350,000, and 6 per cent on the balance of $100,525,250.87—6 per cent of that is $6,031,515.17, or a total of $6,781,515.17.

(Testimony of Robert Buchanan.)

Q. Thank you. Now, in your figures for the year 1942 for the Western Pacific Railroad Company, did you include as a deduction in the computation of its tax on a separate return basis any interest on the bonds of that company then held by the parent corporation?

A. You mean the inter-company interest, I take it?

Q. Well, I think that is a fair description. These were bonds of the railroad company held by the plaintiff corporation.

A. Yes, these are bonds—that is the interest on bonds of the Western Pacific Company, held by the Western Pacific Railroad Corporation. It was an item of $525,784.44. No, that was eliminated in the schedule M before they got to the schedule which shows the income of the individual companies, and I did not take that as a deduction. As a matter of fact, I did make a computation taking that as a deduction.

Q. Would you please give us that.

A. Beg pardon?

Q. Please go ahead and give us that. I take it what you are speaking of now is the computation of the amount your own figures would be reduced by taking that into account? [695]

A. Yes, and also having the creditor corporation taking up a similar amount of income. And I did that for all of the companies for all of the years, 1942, 1943 and 1944, and calculated that the

(Testimony of Robert Buchanan.)

tax would have been, on that basis, $88,000 greater. So in consultation with counsel, they suggested that we eliminate the inter-company interest.

Q. What would have happened, Mr. Buchanan, to the tax computation as to the Western Pacific Railroad Company, if you had taken into its accounts in the year 1942 a deduction for some $525,000 of bond interest?

A. It would have decreased the excess profits tax, but would have increased the income tax, and the net difference would have been $31,995.24.

Q. Do you have a schedule which gives the details of those computations? A. Yes, I do.

Q. Might I ask that this particular schedule be produced, or that we be provided with a copy of that schedule?

A. Yes, I have all the details on those calculations.

Q. Now, is it invariably the rule of the Treasury Department that if a debtor company accruing interest takes the accrued interest as a deduction, that the creditor company, which doesn't receive interest in fact, is required to take the item in as income? A. Yes. [696]

Q. You understand it to be the invariable rule?

A. That is the general rule; now, whether it is the invariable rule, whether there might in some instances, isolated instances, be an exception to that rule, I don't know.

Q. You are not familiar with that?

(Testimony of Robert Buchanan.)

A. No.

Q. Now, I would like to ask you a question or so on the Sacramento Northern Railway computations, which you have made for the year 1942. Excuse me. Before I go to that, may I ask if you will give me a description of the particular schedule that we were just speaking of, under which you computed varying tax consequences resulting from various treatment in these inter-company interest accounts, so that we can have it marked for identification? You have some particular papers that contain those computations?

A. Yes. In fact, all of these computations start with the income shown in the return, and then it shows the adjustments for the inter-company interest, so all of these major schedules, income schedules, show these adjustments. To give you an example——

Q. You don't have any particular computation which brings about this eighty-odd thousand dollar figure we were speaking of a moment ago?

A. Yes, they are all in this set of working papers here (indicating). [697]

Q. Well, you say they are all in there; but do you have a particular paper that has that computation?

A. I would have to go through each one and show the adjustment by years. In other words, we made them separately for each year.

Q. Very well, then.

* * *

(Testimony of Robert Buchanan.)

Q. (By Mr. Adams): Now, then, Mr. Buchanan, directing your attention to the item as to the Sacramento Northern Railway for the year 1942, the income tax of $127,527.71 for that year, would you please state what was the amount of the taxable net income of the Sacramento Northern Railway for 1942 that you used in Basis 1 computations?

A. Yes, I have that right here.

The Court: Now, is there a substantial difference, Mr. Adams, between the amount that is covered by this witness' testimony and the amount you have in mind would be shown by testimony if other deductions were taken, other than the stock loss?

Mr. Adams: Yes, there is a very substantial variance, [698] your Honor, and those——

The Court: Well, what do you mean by that?

Mr. Adams: Let me see if I can call them off generally from memory.

The Court: No, I didn't want to know in detail concerning it. I mean, is it your contention it would be only half as great, a quarter as great, 75 per cent as great, or what?

Mr. Adams: I think if you take all of our figures at 100 per cent value, and of course when we present them and defend them, we do so from that standpoint, then it would appear that upon a separate return basis, consistently carried through—and I mean beginning back before the year 1942, because it makes a good deal of difference whether you did it before then or not—and taking into account this

(Testimony of Robert Buchanan.)

Sacramento Northern loss and cut-backs and reparations figures, that we would come out with a figure that was somewhere in the neighborhood of about, oh, four and three-quarters million dollars taxes for that period. When in fact, $4,200,000 was actually paid.

So that is perhaps a long-winded way of saying we come out with only about half a million dollars.

Now, I will be frank to say that that includes computations on account of one very large potential that cannot be satisfactorily reduced to figures, and that is this reparations suit. If the reparations suit, which is a very real potential, but is yet not susceptible of exact measurement, is left out [699] of our calculations, then our calculations would show something like $7,000,000 tax liability on a separate return basis during those years, leaving in comparison to the figures given here of fifteen and twenty-one.

Mr. Phleger: I take it your Honor understands that the Sacramento Northern loss is what would have happened had they sold the railroad that they still owned, and haven't sold; and the loss on which they didn't take in the last eight months of '44, when they in fact paid several millions in taxes; and it is also my understanding of the tax law that when you accrue as income amounts which are subsequently not paid and you were on an accrual basis, your remedy is to charge those off as losses when the loss is ascertained. So that the result of

(Testimony of Robert Buchanan.)

these reparation claims are that if, as and when—which we hope never will happen—the $3,000,000 lawsuit is determined adversely to the railroad companies, the railroad companies will then be in a position to charge off in that year the amounts which they have theretofore accrued as income and paid income tax on. That is the penalty of keeping your books on an accrual basis.

Mr. Adams: Your Honor, this is way ahead of us. We haven't even put that case in.

The Court: Yes. All I wanted——

Mr. Adams: I didn't want to let Mr. Phleger's statement go back with just a general caveat that we haven't presented [700] the Sacramento Northern loss; it is not as he defines it.

The Court: I just wanted to find out how important this stock loss was, whether or not the railroad company could escape without any taxes without filing the affiliated return. But it is obvious from what you say that they would have had to pay, even assuming you could establish all the deductions, the $7,000,000 anyhow. I just wanted to get the general picture of that.

Mr. Adams: Yes, your Honor.

Q. Now, I was taking up with Mr. Buchanan this figure for the Sacramento Northern Railway, and I asked what was the amount of the taxable net income that you used in computing the $127,000 income tax for '42.

A. It was the amount shown in the consolidated return for 1942.

(Testimony of Robert Buchanan.)

Q. And what was that?

A. Of $7,424.36, plus a net operating loss carried over from 1940 of $311,394.91, or a total of $318,-819.27, which, at 40 per cent, gives $127,527.71, found in the column under the year 1942, in Basis 1.

Q. So that this computation, then, is arrived at by adding to the $7,000 income shown in consolidated returns an amount described as net operating loss carry-over? A. That's right.

Q. Now, is it the fact, Mr. Buchanan, also with reference to [701] this Sacramento Northern Railway tax computation, that you have not taken into account the interest accrued on any of the indebtedness in the Sacramento Northern?

A. That is correct. There is $801,000 of that inter-company interest that is eliminated in the consolidated return, which we didn't take up. Although we have a basis for showing its effect when it was taken up as a deduction previously, which computation I previously referred to. [701A]

Q. You are addressing yourself now to your general statement that you worked this thing out all across the board and disappeared, it balances out or almost substantially so?

A. That's right.

Q. But however, that is not to say that in this particular instance of which we are speaking, there was some eight hundred odd thousand dollars deductions of the Sacramento Northern that you haven't taken into account in making that?

A. Oh, on that computation, right.

(Testimony of Robert Buchanan.)

Q. Right. And now referring to the column for the year 1943, our Basis 1, would you say that the computation——

A. For which company?

Q. For the Western Pacific and the Sacramento Northern. Those are the ones we have been speaking of, I take it? A. Yes.

Q. Referring to that column, would you say that your computations for '43 were similar to those which you have just described in the case of '42 for those two companies? A. Yes.

Q. Now referring to the third column on the Basis 1, a period from January 1 to April 30, 1944, you note in the Western Pacific Railroad Company column you have a figure of $1,295,616.56 for excess profits tax of the railroad company for that four months' period? A. Yes. [702]

Q. Did you calculate that tax solely upon the income figure of $2,975,142.13, that you referred to in your testimony this morning?

A. Let me give you the detail of that.

Q. Perhaps you might say "no" if that question is not correct.

A. I would have to look up the computations to refresh my mind.

Q. Surely.

A. Now that computation, the net income for declared value excess profits taxes is $2,975,142.13. And then there is added to that 50% of the interest on borrowed capital, $454,447.27, making a total of

(Testimony of Robert Buchanan.)

$3,429,589.40 from which there is deducted a figure dividend received credit of $30, coming down to $3,429,559.40; and from that is deducted a specific exemption prorated of 4/12 of a year, $5,000 for 4/12 of a year, which figures to $1,666.67, and the excess profits credit is also prorated for 4/12 of a year, arriving at the amount of $1,912,551.73, giving a total excess profits credit of $1,914,218.40, which leaves as subject to excess profits tax, $1,515,341.00, and the tax is 95% of that amount, or $1,439,573.95. From that is deducted the post-war refund of 10% thereof, or $143,957.49, coming down to a tax, an excess profits tax, of $1,295,616.56, which is the figure about which you are asking.

Q. Yes. Now from what source did you derive the excess profits credit figure which you then prorated by taking a third of it? [703]

A. That is that same figure that I gave you a little while ago, taken from the return here, as the $110,000,000 figure. No, let's see. That is—let me make sure of this. This is the 1944?

Q. Yes.

A. That is taken from the return itself, showing an equity invested capital—do you want me to read all the details?

Q. I asked you the source of the excess profits credit figure that you used in the computation.

A. The source of the returns which show money paid in for stock of $800,000, property paid in for stock, $75,000,000, or a total of $75,800,000. This is

(Testimony of Robert Buchanan.)

the Western Pacific. And borroweed capital of $73,000,000, half of which is thirty-six million odd. That gives one hundred twelve. And then there is an adjustment of inadmissible assets of $2,000,000, bringing the invested capital to $110,753,104.08, which is apporximately the same as we have here for 1942, and to that invested capital figure is applied the percentage rates, coming to an excess profits credit of $5,737,655.20, and then the credit is prorated, 4/12 of that amount resulting in this prorated credit of $1,912,551.73. [704]

* * *

Q. Now, Mr. Buchanan, directing your attention to your schedule, Basis 2, I take it what you told me with reference to Basis 1, as far as the possible deductions I have mentioned are concerned, that is, the Sacramento Northern partial bad debt loss and the accelerated amortization and the cut-backs and refunds and the reparations claimed, I take it that no account of those matters is taken in your figures on Basis 27. A. That is correct.

Q. Now, in Basis 2, you say, among other things, in your title "Giving each affiliate the benefit of any operating loss carry-over or unused excess profits credit carry-over attributable to it," and I would like you to explain, if you will, just what process you followed in giving those benefits in your computations, Basis 2. [705]

A. Yes. You will notice that the difference between Basis 1 and Basis 2 is that in Basis 1 we

(Testimony of Robert Buchanan.)

have an excess profits tax of $4,713,594.03, whereas in Basis No. 2 we have no excess profits tax. Now, explain that difference where you start with the net income shown as a return, the same as used in Basis 1, $10,806,257.38, and we add back to that what was added back in the return, the operating loss of $438,280.24, and the 50% of interest on borrowed capital of $1,298,956.10. And I might say in passing that adding back the $438,280.24, that is the entire net operating loss, whereas that should have been the net operating loss deduction, which is really the operating loss less certain adjustments for non-taxable income, dividends, and capital gains. But we put that figure in because that is the figure used in the return, and it would not materially affect the results because of the very large credit that we come up with in 1942. But I just want to point out that fact. That gives us an excess profits net income of $12,543,493.72. The entire excess profits tax is wiped out because we have the current credit, that is, the excess profits credit for the year 1942 of $6,781,515.17, and then we have a carry-over from 1940, unused excess profits credit of $7,725,229.71 and an unused excess profits tax credit carry-over from 1941 of $7,633,732.80, or a total carry-over for those two years of $15,356,962.51. The unused excess profits carry-overs for the years 1940 and 1941, added to the current year's credit, gives a total credit of $22,138,477.68 applied to the excess profits net income of $12,542,463.72 and,

(Testimony of Robert Buchanan.)

of course, the excess profits tax is wiped out and is zero, as is shown in column 1 of Basis 2. So the principal difference between Basis 1 and Basis 2 is the result of these carry-overs.

Q. Let me ask you one or two questions about Basis 3. Is it correct to say that your computation on Basis 3 is made by using the data in the consolidated returns as filed without any change or adjustment except elimination of the corporation's stock loss? A. That is correct.

Q. So that in effect this computation is a computation of what the consolidated tax returns would have shown as taxable income if the loss had not been taken as a deduction in those returns?

A. That is correct.

Q. And I take it, as in the case of Bases 1 and 2, you have not taken into consideration the adjustments for accelerated amortization or for cut-backs, refunds or for the reparations claim in those computations? A. That is correct.

Q. Just one more question about the figure in the column Basis 3 for the period January 1 to April 30, 1944. I notice that there is a note there "Corporation's excess profits credit for 1944 prorated." A. That is right.

Q. Correct me if I am wrong about this, but I will try to state [707] what I understand the return shows in this regard. The return shows the parent corporation's excess profits for the last twelve months, does it not?

(Testimony of Robert Buchanan.)

A. That is correct.

Q. And that excess profits credit is a figure entering into the computation of tax liability?

A. That is right.

Q. And to reduce it to ⅓ of that figure would increase the resulting tax liability?

A. That is right.

Q. Is it not the fact that the return as filed by the parent corporation under the law covered the whole year for the parent corporation?

A. Yes, but all the subsidiaries were in there only for four months.

Q. The subsidiaries were in there only for four months? A. And if it were deemed——

Q. Did the law require that in the computation of tax liability under the return to parent's excess profits credit be cut 2/3, as you understood?

A. As far as I could find, the law is silent on that point, and under the consolidated income tax regulation, since the subsidiaries had all gone out of the picture, that was the reason for our prorating it. In other words, it might well be put that the treasury department would say that it had to be prorated for [708] that reason. That was our reasoning.

Q. Are you satisfied in your mind whether or not the Treasury Department would have made that requirement?

A. I don't know. It seemed to me that might well have been required for that reason. I looked up

(Testimony of Robert Buchanan.)

some regulations; I couldn't find any ruling on the subject.

Q. Have you made any computation covering that four months' period of what the figures entered in your Basis 3 item would have been if you had taken the full amount of the twelve months' excess profits credit?

A. No, I have not. [709]

* * *

Mr. Phleger: This morning, in connection with Plaintiff's Exhibit 73, which you recall were six sheets representing an income tax computation prepared by one Reilly, I asked counsel to stipulate who Reilly was, but I think I forgot to ask him to stipulate that those sheets were prepared by Reilly. Will you so stipulate?

Mr. Adams: I think that is what the record shows.

Mr. Clark: That is right.

Mr. Phleger: That is not my recollection. We identified Reilly but we did not have a stipulation that Reilly prepared them, which he in fact did, as shown by the deposition.

Mr. Clark: May we have the stipulation now?

Mr. Adams: Oh, yes. I think the record shows that. If it does not, I so stipulate.

Mr. Phleger: If it please the Court, this terminates the presentation of our case in chief. I will conclude by offering Plaintiff's Exhibit 1 for iden-

tification, the chart showing corporate relationships. [711]

* * *

Mr. Adams: I am just making an objection to a chart that I do not think is fairly representative of the evidence.

The Court: This has nothing to do with what your contentions are in the case. Your opponent is merely offering the chart as a summary of what he says his witnesses have already testified to and what the record he has already introduced shows. It is not offered for any more than a summary of the evidence he has presented. It does not prove anything in the case. The chart does not prove anything.

Mr. Adams: May I respond to his Honor, because I think his Honor's request was directed to me. I would have no objection to the production of this paper if all that were sought to be accomplished by it is the same thing that is accomplished by a brief. I do not understand how it can be that something that purports to be in effect a brief on the part of one party to the litigation can be admitted in evidence as evidence or proof of any fact.

The Court: We admit all sorts of things for limited purposes in evidence, and that takes care of that matter, and if this is admitted only as a summary of what has already been testified to, if there isn't any testimony to state it, the chart does not mean anything. It has that limitation to it when it is admitted. [713]

Mr. Adams: Well, in other words, as I understand your Honor, then, admisson of this chart in evidence does not tend to prove anything that is not otherwise proved for the record.

The Court: Of course. I have said that several times. I think that is all any chart is admissible for.

Mr. Adams: Then in that case, I confess that I don't have a very good ground for objection to its admission in evidence.

The Court: I think these charts may be admitted as charts, as summaries of the testimony already in evidence, and not in proof of any fact thereon stated—unless there is evidence to show the things that are set forth in the chart.

Mr. MacKinnon: May I inquire whether there is any evidence to support the stock holdings indicated on the chart of Sacramento Northern, Deep Creek, Standard Realty and Tidewater Southern, at the present time?

Mr. Phleger: Yes, in the income tax report of the Western Pacific for the last eight months of 1944; also in the annual reports of the Western Pacific Railroad for 1944, '45, '46 and '47.

The Court: Well, if there is any inaccuracy in these charts, why, you can treat them in effect as if they are brief presentations of the evidence.

Mr. Phleger: Now, I take it that covers——

The Court: How many charts have you got there?

Mr. Phleger: Plaintiff's 1, which is the corporate [714] relationship. Plaintiff's 2, being the positions held by the officers, and I will offer the chronology as 2-B.

The Court: Very well, they will be admitted for the purposes and on the basis of the Court's statement.

(Plaintiff's Exhibts 1 and 2 for Identification were received in evidence; chronology chart referred to was received in evidence and marked Plaintiff's Exhibit 2-B.) [715]

* * *

(The Plaintiff rested.)

Mr. Clark: May it please your Honor, on behalf of the interveners, I will ask all counsel in the case for a stipulation that the intervener, Henry Offerman, now owns 4080 shares of preferred stock of the plaintiff corporation, and has been a stockholder of the plaintiff since July 7, 1942; that the intervener J. S. Farlee & Co., Inc., is the owner of 10,000 shares of the plaintiff corporation and has been a stockholder since January 10, 1944; and that Meredith H. Metzger, formerly [716] Meredith H. Van Kirk, who was substituted for her deceased husband by order of this Court on January 28, 1949, is the owner of 11,385 shares of the plaintiff corporation, 8200 shares of which were distributed to her from the estate of her deceased husband; and that he had been a stockholder of the plaintiff corporation since February 23, 1944.

Is it so stipulated, gentlemen?

Mr. Adams: I would like to respond to that very briefly, Mr. Clark. In the first place, I told Mr. Clark, and I will stipulate to the fact upon his assurance that it is so,—which he gives me—that whatever stock ownerships were developed at the time the depositions were taken, and those related to Mr. Offerman and Mr. VanKirk and the J. S. Farlee & Co., are still existent. This is probably just what Mr. Clark has said.

Now, with regard to Meredith H. Metzger, Mr. Van Kirk's widow, we agreed also that she might be substituted in the case subject to the same defenses and disabilities that her husband might have had. So when Mr. Clark refers to the fact that she also comes individually as a stockholder in her own right to some small number of shares, I wish it to be understood I haven't agreed she might come in the case late not subject to those disabilities and defenses. With that statement, I take it that what Mr. Clark has said is substantially what I have said. [717]

Mr. Clark: Well, may it please your Honor, of course the Metzger substitution is covered by a written stipulation, and a court order which was made pursuant to a stipulation signed by all the parties. Now, as to the amounts I read, they are slightly larger than the amounts developed on deposition, due to the fact that in the meantime, some treasury stock of this plaintiff corporation was offered to the stockholders, and these people have taken their pro rata shares of that offering.

The figures are substantially above those developed on deposition, in that Offerman was shown to have held some 3090 shares, and the figure I gave was 4080 shares.

With that one point, pointing that one thing out to the Court, my statement is substantially in accord with that made by Mr. Adams, which was agreed to on pre-trial, with the exception of the small additions.

Mr. Adams: As to the small additions, your Honor, I take it that Mr. Clark is not insisting that because of these additions, his clients have any better position.

Mr. Clark: No, I am simply trying to give the correct amounts.

Mr. Adams: And further, that the prices paid for those small additions may be stated as they have been, with respect to the other stock; if you have the prices, I would be grateful if you would state them, and we will accept your statement.

Mr. Clark: I don't know the price for that. [718]

* * *

(Letters previously identified as Interveners' 67-A, -B [721] and -C, dated February 11, 1947, referred to above, were received in evidence and marked Interveners' Exhibit 14.)

Mr. Clark: And the record, of course, shows that the plaintiff corporation received no notice of any such offer of settlement until the following April. [722]

* * *

Mr. Levy: I should like to read into evidence certain portions of the deposition of Mr. Robert E. Coulson taken in New York; first from page 5702:

"Q. Mr. Coulson, you are a member of the bar of the State of New York? A. Yes.

Q. And a member of the firm of Whitman, Ransom, Coulson & Goetz? A. Yes.

Q. Are you the Mr. Coulson of the firm name?

A. Yes."

Page 5704:

"Q. When did you first become affiliated with the firm of Whitman, Ransom, Coulson & Goetz, as it was then known? A. January 2, 1919.

Q. Have you continued with that firm since to date? A. Yes."

5709:

"Q. In the course of your activities for the firm of Whitman, Ransom, Coulson & Goetz did you engage in legal services for Arthur Curtis James during his lifetime? A. Yes.

Q. Can you give us a brief picture of the nature of the [723] services that you performed upon his behalf?

Mr. Levy: Generally.

Q. The answer can be general as well.

A. Generally I acted as counsel for him in many of the matters which arose in New York.

Q. Did those matters involve tax work?

A. Yes.

Q. Did they involve corporate work?

A. Some of them involved corporate work.

Q. Did they involve legal advice in connection with business dealings, that is, the acquisition of property or the sale of property? A. Yes.

Q. Would you say that a considerable part of your activities on behalf of Mr. James were in the tax field during his lifetime?

A. A substantial part was, especially in the early years, Mr. Levy.

Q. During your activities with the firm of Whitman, Ransom, Coulson & Goetz did you perform legal services for the various James companies?

A. Yes.

Q. Did those services cover the general field of law practice? A. Yes. [724]

Q. Did they include tax work?

A. Yes, again with a qualification, Mr. Levy. In the early years I dealt with the tax problems personally and in the later years, why, the office, the firm would deal with them and I would know about them.

Q. When did you become a partner in the firm?

A. January 2, 1919.

Q. Have you during any period of your work with the firm been the partner in charge of the legal services rendered by the firm for Mr. James and his companies? A. Yes.

Q. During what period would you say that was true? A. For almost 20 years.

Q. Has it continued to date?

A. Yes, subject to the qualification that Mr. James has no companies at the present time. They have all been dissolved.

Q. Since Mr. James' death have you represented the estate of Mr. Arthur Curtis James?

A. Yes, our firm has represented the estate since his death.

Q. Your firm has also represented the James Foundation during this period? A. Yes.

Q. And you are the partner who was in charge of the [725] work performed for the firm for both of those clients?

A. Yes, for the estate, that would be under the partner who is the head of the probate work, Mr. Chambers.

Q. In connection with handling the estate, are you kept generally familiar with the progress there?

A. Yes.

Q. During the reorganization of the Western Pacific Railroad Company the firm represented the A. C. James Company, did it not?

A. That is correct.

Q. Were you the partner in charge of your firm's activities in that connection? A. Yes.

Q. By the way, we have developed the practice in these proceedings of referring to the railroad company as the company and the railroad corporation as the corporation, so if I say the company I mean the railroad company, and if I say the corporation I mean the railroad corporation.

During the years 1943 and 1944 your firm was likewise tax counsel to the trustees in bankruptcy of the railroad company, were they not?

A. The firm was retained sometime in 1943 to

act for the trustees under Section 77 in the reorganization proceeding." [726]

(The next page is 5819:

"Q. I believe you have already testified that from 1943 to date your firm has been counsel to the A. C. James estate, the Foundation, and the A. C. James Company up to the time of the dissolution?

A. Yes.

Q. As counsel for those various clients did your firm do tax work and corporate work?

A. Yes, we were general counsel.

Q. Did you draw the will of Arthur Curtis James?

A. Yes, in the sense that I was the responsible draftsman. Our probate department, of course, worked on it. It was a composite job, both the will and the codicils.

Q. Would it be correct to state that the securities of the railroad company held by the estate and the Foundation were an important asset of the estate and the Foundation?

A. They represented substantial value as well as a much larger investment.

Q. Had you from time to time held a position with any of the James companies other than that of counsel?

A. Yes, I had been for some years a director of the Curtis Southwestern Company and the Curtis Southwestern Corporation and the A. C. James Company. [727]

Q. Had Mr. James requested you to assume

those positions in those companies? A. Yes."

Page 5718:

"Q. Was the effect of taxes on earnings a vital factor to your clients, the A. C. James Company?

A. Yes, in that they expected to receive securities in the reorganization. The property, you understand, was in the hands of the trustees and in the process of reorganization." [728]

* * *

Mr. Adams: I have not hitherto understood the statements made on behalf of the plaintiff—they were made largely on behalf of the plaintiff—that the defendant took over this tax matter to relate to particular conduct of any particular gentleman who was involved in these transactions. I had understood the plaintiff's case to be a contention that these tax returns were filed by a variety of people—Mr. Curry was one of them, Mr. Schumacher was another, and so on—whom he has up there on his chart, and that the tax returns were advantageous to the defendant, and that all that was intended by a statement that the matter was taken over was that that was the way it was done, without any implication of any sinister or improper motive, but only that it was done, and the complaint was that the plaintiff had some rights in the matter about which the plaintiff [731] is now in court. Now, do I understand that it is interveners' view that there was any misconduct, improper motive or improper action on the part of any actor in these

proceedings? I would just like to be sure what these charges are that are being brought against us so we may know what it is we have to answer.

Mr. Levy: I think the facts speak for themselves, your Honor.

The Court: I am not too sure about it.

Mr. Levy: I will spell it out a little. I do not want to dodge the question.

The Court: You are suing the railroad company here, aren't you?

Mr. Levy: Yes, we are.

The Court: And it is your contention that the railroad company dominated this tax situation. Is it your contention that the railroad company in turn was dominated by this gentleman, Mr. Coulson?

Mr. Levy: No, we have not made that contention in the course of this trial, your Honor. What we have contended is this: We have contended that through the dual relationships of these officers and directors and through Mr. Coulson's domination of the corporation, the plaintiff in this case, and through his position as tax counsel, wherein he dominated the handling of these tax matters, and through having put Mr. Curry in his own office since May 1, 1945, he did in fact—— [732]

The Court: Mr. Coulson was not a director of the corporation, was he?

Mr. Levy: He was until 1942; but your Honor will recall that the James Foundation owns 40 per cent of the stock of this plaintiff.

The Court: In the period with which we are concerned he was not a director?

Mr. Levy: He was not.

The Court: Nor an officer?

Mr. Levy: He was not, but he was its tax counsel with all these conflicting pulls operating upon him.

The Court: What is it that he did that the defendant did not do that gives you any cause of action that you did not have before?

Mr. Levy: I will put it this way: What the defendant did, it did in part through—for instance, the failure to advise this corporation as these returns were going in of whether or not separate returns could be filed, of whether or not the corporation was assuming liabilities, of whether or not the corporation had another course of conduct which it could have pursued—he did that. He is a member of the firm and he did it, and the testimony will show he actively participated in the various events as they took place.

The Court: Of course, if he did it without the knowledge and consent or against the consent of the plaintiff, then maybe you [733] might have named him as a defendant and charged him with some form of conspiracy and the Court might properly find what he had to do with the matter.

Mr. Levy: He was working for the railroad.

The Court: Is there anything more than that under the circumstances that have been described that, as you have urged heretofore, the defendant

caused the preparation of the returns which the plaintiff signed?

Mr. Levy: Other than this?

The Court: I say, what does this add to it?

Mr. Levy: Well, I think this particular letter, your Honor, adds——

* * *

The Court: What difference does it make what he said to somebody else concerning the matter?

Mr. Levy: That is not the point, your Honor. I think the point is this: The point is to me, Did Mr. Coulson represent both companies and what were his conflicting tugs? That is one of the issues in this case.

The Court: What difference would it make unless the defendant is chargeable with it?

Mr. Levy: Now, I think the defendant is chargeable with it [734] in this sense: Everybody knew who Mr. Coulson represented. That was no secret, your Honor.

Mr. Adams: Certainly there was no secret about that.

Mr. Levy: I am not saying there was anything invidious about his representations, but it is a part of the duality, your Honor.

The Court: Is there any secret about the fact that Coulson had represented these other interests?

Mr. Levy: No.

Mr. MacKinnon: It was spread right out through the reorganization.

Mr. Levy: There was no secret about that. I am not contending there was.

Mr. MacKinnon: This is a little more color, that is all.

Mr. Levy: I do not agree with that. This piece of evidence gives you a piece of evidence that you do not now have in the record. There is nothing in the record that shows that as of that date, and during the period of the reorganization, during this critical period, the James interests had and viewed their standing as being that of a group representing 21 per cent of the stock of this railroad company when it was issued. Now, that is a strong tug for a man who is representing both the railroad company and the corporation in determining where his interests lay, as to who should get any savings that flow from taxes. [735]

The Court: You are not expecting to get me into an evaluation of the tugs that are involved in this case? If that is the case, it would open the door to all sorts of testimony concerning this gentleman, Mr. Coulson, what he thought about it, whom he spoke to, what his views were as to his respective loyalties, duties, and so forth and so on.

Mr. Levy: I am pointing to objective facts, not subjective facts. [736]

* * *

But we do feel that your Honor is absolutely right that on one leg of this case this stuff has very little to do with it. We do feel, though, that there is a second leg of the case, and although your Honor may not give any judgment based upon it, we feel there is a basis for the claim perhaps in an

appellate court, if we ever have to go that far, and they will agree with us on that leg of it. [738]

And along those lines the basis of our claim can be simply stated that over and above what dual relationships produced, which is enough to make the case, if there is unfairness, if there were a conscious using, you have got a different kind of a case with different legal incidents. Now, one of the elements of this conscious using is mode of use to benefit one against the other. [738-A]

The Court: Well, I can follow all that argument or I could if there were some concealment involved. But when everybody was, as they were in this case, acting completely in the open in the matter, nobody was concealing anything from anyone else, the element of fraud or deception, of the kind that you refer to, is absent. So you have to decide the matter then on the basis of whether or not, under those facts and circumstances, there was nothing that was either legally or equitably wrong or disadvantageous to one party or the other, done. You don't enter into these questions of fraudulent overreaching unless you have got some element of concealment involved in the case, and equity; your reading of equity will satisfy you on that, of the principles of equity, and you are not charging or claiming that there was any of that kind of deception in the case. Everybody knew that consolidated returns were being filed. Everybody knew who the directors were. Everyone knew that these attorneys were being employed to file this consolidated return. It was all done right out in the open. The

question that you have to present in this case is, now, can we go back and under principles of equity, redetermine the transaction on the basis that a legal or equitable wrong was done by what was done.

Mr. Levy: Your Honor, that is a very persuasive answer to our contention, and perhaps your Honor is ultimately right. But you say that there is no concealment here, and there is no secrecy. I just want to point out two things to you, without [739] going into the record to give you more. One is, why do tax attorneys who represent two participants in a consolidated return fully advise one and not advise the other at all? That is unnatural; let's at least call it that. Let's go to the settlement in February 11. Let me just pursue that one moment.

The Court: Well, all I have to say to you there, Mr. Levy, is that I don't think it is necessary to carry that argument forward now. Everybody knew, didn't they, that the consolidated return was being filed? So that the defendant railroad company wouldn't have to pay any income tax? That was why it was filed, wasn't it?

Mr. Levy: Yes, your Honor.

The Court: Nothing else is of any importance; that is why it was filed.

Mr. Levy: Yes.

The Court: With that in mind, nobody had to conceal anything from anybody else. That is why they did it. They filed a consolidated return and took this loss so the railroad company wouldn't

have to pay any income tax. They made use of the stock loss of the parent company to avoid paying the income tax. Now that is what they did.

Now under the particular circumstances that we have in this case, you have presented a very unusual, and I think at this point, a difficult question, which involves whether or not there was a cause of action now on the part of the plaintiff [740] because of those circumstances. Now isn't that the case here?

Mr. Levy: That is one leg of it. Undoubtedly——

The Court: Well, if it hasn't got that leg, it hasn't got any leg.

Mr. Levy: Absolutely. That is a very important leg of it, and that may be the only part of the case that your Honor feels he is going to have to decide. But rightly or wrongly, and certainly without any desire to prejudice the plaintiff's case, we think that there is an argument to be made on another leg. Now we may be proceeding mistakenly, and we certainly have tempered our presentation of it in an effort not to take too much time. We have spent an awful lot of time talking about one piece of paper here. [741]

* * *

Mr. Levy: Now I should like to read from Mr. Coulson's deposition, on page 5740: (reading):

"Q. In what capacity did you write the letter of June 26 to Mr. Curry, Interveners' Exhibit 64?

"A. For that, I would like to see the prior letters, Mr. Levy, because it is a continuation of cor-

respondence which apparently started with a letter of April 12, 1943, from me to Mr. Curry, and a letter from Mr. Curry to me of May 15, 1943."

Whereupon the requested documents were exhibited to the witness. (Continuing):

"Q. Will you answer the question, Mr. Coulson?

"A. That letter was written in the capacity of counsel to the James Foundation of New York, Inc.

"Q. I notice that the last paragraph of Interveners' Exhibit 64, your letter of June 26 to Mr. Curry, states: 'Before the Foundation gives a final and definitive answer to your proposal, I would wish to discuss with Mr. Polk the tax aspects of the problem and make that information available to the trustees of the Foundation.'

"Now I show you interveners' exhibit 60,——"

This is Plaintiff's 51 in this case.

"——your memorandum of June 26——" [744]

The same date, 1943,

"——to Mr. Polk, and ask you whether that is one of the tax problems taken up with Mr. Polk in connection with your letter of June 26, Interveners' Exhibit 64."

"The Witness: This memorandum speaks for itself, being on the same date. I have no recollection independent of the documents here, Mr. Levy. It was a memorandum written to Mr. Polk on the same date as the letter to Mr. Curry, and refers to tax problems which might arise, or tax aspects of the continuation of the corporate charter of the holding company."

Now, continuing on page 5743: (Reading):

"Q. Can you tell us in what capacity you directed the memorandum of June 26 to Mr. Polk?

"A. Was, to the best of my recollection, as counsel for the James Foundation of New York.

"Q. In your memorandum to Mr. Polk, Interveners' Exhibit 60,——"

Which is Plaintiff's 51.

"——you use the following language:

"'Will it embarrass you in the Western Pacific . . .'

"Was the Western Pacific situation referred to, Mr. Polk's activity as counsel to the trustees in tax matter? "A. Yes. [745]

"Q. What was the relationship between the Western Pacific tax situation and the Foundation on or about June 26, 1943?

"A. The James Foundation held, directly and indirectly, as creditor, a substantial tentative in the Western Pacific reorganization, and was interested in the ultimate outcome of this reorganization, and hence, interested in anything that benefited the earnings and assets held by the trustees in bankruptcy."

* * *

The Court: Well, you don't need the letter in for that; they will stipulate with you on that, won't they, as to what the percentage was?

Mr. Levy: If they will, I will accept the stipulation, based on Mr. Coulson's letter, yes.

The Court: If all you want to show is the percentage, subject to its materiality——

Mr. MacKinnon: The plan shows what they got.

There is no secret about that.

Mr. Adams: Yes, there is no secret about that.

Mr. MacKinnon: They got it under the plan of reorganization.

The Court: The figure was correct, was it?

Mr. Adams: Let us see how it is stated here; this may be an abbreviation.

Mr. Levy: 21½% of the voting stock of the reorganized company.

Mr. Adams: I think that is correct. I will stipulate to it.

The Court: You don't need to put the letter in.

Mr. Adams: That is a statement that the James Foundation and the A. C. James Company together came into 21½% of the voting stock of the reorganized company under the provisions of the [748] plan, and the securities they held.

Mr. Levy: I think that says it, your Honor.

The Court: All right. [749]

* * *

Mr. Levy: Will it be conceded that 100% of the stock of the Western Realty has been owned since April 30, 1944, by the James Foundation of New York, Inc.?

Mr. MacKinnon: Subject to correction, yes. The exact dates are the thing in question; if they would be shown to be [752] changed, I will reserve the right to make the change. [753]

* * *

Mr. Levy: I hope I won't take too much more time as a result of precipitating these debates.

On page 6144 (reading):

"Q. Has the retainer arrangement with Mr. Curry been terminated?

"A. No, it has been terminated, but is still in effect. It has been terminated as of the end of the year 1948.

"Q. Did you discuss the termination of that retainer with any representative of the railroad company?

"A. Not to my recollection." [755]

Mr. Levy: I think I have no more, your Honor. That concludes the reading.

Mr. Clark: The interveners rest, your Honor.

(The interveners rested.)

Mr. MacKinnon: Your Honor, I should like to make a motion at this time to dismiss the complaint in intervention purusant to Rule 43, I think it is, of the Federal Rules of Civil Practice on the ground that the complaint in intervention has not been established by any evidence adduced, and whatever will meet your Honor's wishes, whether it be done at length, I will comply with.

The Court: Of course, I allowed the intervention.

Mr. MacKinnon: What is that?

The Court: I say the intervention was allowed.

Mr. MacKinnon: I appreciate that. The complaint in intervention is a pretty drastic pleading, and I say on the basis of the proof—and that is what we are dealing with—their complaint, in

which they charge a conspiracy here, I say there is no evidence to sustain a conspiracy. If they want to withdraw and restrict it, we will meet whatever cause of action there is, but as I understand it, they are resting on their complaint, and under the circumstances I do not think they made their case, and since they have not made their case I am prepared to discuss it at length or briefly, whichever your Honor wishes. [756]

The Court: Doesn't the complaint in intervention also adopt the plaintiff's cause of action?

Mr. Clark: It not only adopts it, it injected it into this case for the first time, your Honor. There was not an issue of duality in this case until it was allowed, and that is why it was allowed.

The Court: There was an amended complaint.

Mr. Clark: Yes, months later, which adopted in part the theory of the stockholders' action in New York and also the theory of the complaint in intervention. To answer your Honor's question, yes, the duality is the substance of the complaint in intervention.

Mr. MacKinnon: I do not think it is. I think there is a plan and conspiracy charged in the complaint in intervention, and domination and control is alleged from the beginning to the end. Now, if you want me very briefly to refer to the allegations——

The Court: Of course, there is no conspiracy involved here.

Mr. MacKinnon: Then let us have it on the record. Let us know what we have to meet.

The Court: What you are really interested in is knowing how far the defendant has to go in its proof?

Mr. MacKinnon: That is right. We have to know what we have to meet. That is what we want. I think it is time for [757] interveners to fish or cut bait.

Mr. Clark: That issue, if it please the Court, was defined on pre-trial. I handed up a letter to your Honor. I read it to your Honor, and everyone was advised of the restriction of the allegations which were made at the time of the intervention for purposes of the trial. Mr. MacKinnon had notice of that long before even the pre-trial conference. This complaint in intervention, if it please your Honor, was drawn at a time when the corporation had come out here, a few weeks after a motion to dismiss in the New York action had been denied, which had been interposed by defendants there, at a time, may it please your Honor, when the directors of the plaintiff corporation were named as individual defendants in New York, in the action brought by interveners as plaintiffs, at a time when Mr. Curry was officing in Mr. Coulson's office, Miss Valouch was there, they being president and secretary, and the complaint which the corporation came out here with and then filed did nothing more than to allege the fact that these returns had been filed and the stock loss used. There was not the least suggestion of the capacities under which the people had acted or anything

of that kind, and we came here, may it please your Honor, and Mr. Levy associating my firm for the purpose of intervening in that action, and on the evidence as we then knew it, depositions having been taken in New York, we made the allegation that both the defendant company and the corporation were dominated by the James interests, and we did allege what amounted to a deliberate plan to use these stock losses for the advantage of the defendant company. Now, those allegations were in the complaint. But also in that complaint was injected for the first time in this California litigation the issue of duality, and we detail as much of it, may it please your Honor, as we then knew, such as Curry's conflicting positions and the conflicting positions of Mr. Nicodemus, who was still counsel at that time for the plaintiff corporation. That was the petition of these stockholders at that time when your Honor on that showing, may it please your Honor, allowed us to intervene, and I assume the order allowing the intervention has long ceased to be appealable. That complaint stood all through the following couple of years, a year and a half, while we, the interveners, pressed forward the discovery proceeding and developed all this evidence that has been produced before your Honor, every bit of it, and when we came up to the pre-trial conference counsel asked me informally how much of this domination thing we intended to rely upon, and in my letter to them, which I read to the Court, after my first having

asked them if they intended to insist upon an amended complaint pleading, we specifically say, may it please your Honor, that in addition to the duality, which is the foundation of the complaint in intervention, we intended to rely on the theory which Mr. Levy has described as one leg of the case—and we [759] restricted it to the period commencing January 1, 1943, and later on pre-trial said March 15, 1943—namely, on that leg we describe the domination by the James interests through the activities of Coulson of the plaintiff corporation for the advantage of the railroad company while he, Coulson, was counsel for the railroad company. May it please your Honor, prima facie that showing has been made so far as supporting the allegations in the complaint as abridged by my pre-trial stipulation. There just is no doubt of it, and in addition to that the complaint in intervention proceeds upon the theory of duality. Instead of that being a fit subject at this time, your Honor, for a motion of this kind, I suggest to your Honor that if the complaint in intervention is supported by any of the evidence here, it should be allowed to stand, and at the conclusion of the trial, then if it is necessary we can conform to the proofs, and I think in view of the discussions between the parties before the pre-trial on this very subject, that Mr. MacKinnon's motion at this time is out of order.

Mr. MacKinnon: I do not think it is, your Honor. I think it is right on the nose within Rule

43 of the Federal Rules. They make their case or they don't make it. They have charged a conspiracy here. They have charged domination and control, and their complaint in intervention bristles with it. Now they say, if I understand them correctly, "We want to rely on duality but we do not want to take that position on the record." [760] Let them take a position on the record so that we know exactly what we have to meet. That is all I am saying. But they can't both say, "We are relying on a complaint in intervention which charges such matters as those to which reference has been made, and they are going to ask you to draw every inference they can from what I say is a definitely limited record here—definitely limited—this record amplified will explain many of these transactions. They take an isolated document out of its setting. They introduce it. They are going to ask your Honor to draw inferences from it. Are we to be circumscribed? We cannot be circumscribed, unless we know what they are making as their record, if they are standing on domination and control. If they are standing on conspiracy, we will meet it. But on the present state of the record they have not sustained domination and control. They have not sustained conspiracy, and by reason of their failure of proof I do not see any other alternative except to dismiss. If they want to rest on duality, let them say so.

The Court: Isn't there some evidence that supports the argument that there was in a legal sense domination and control?

Mr. MacKinnon: I do not think there is.

The Court: Without having any sinister connotation attached to it or anything that savors of fraud or deception; that by virtue of the facts as they actually occurred, the [761] positions of the parties, their relationship to one another, there was in fact control?

Mr. Clark: That is precisely the point, your Honor.

The Court: It does not necessarily have to be for a sinister purpose. There is nothing wrong about having exercised control.

Mr. MacKinnon: Obviously not.

Mr. Clark: Plus the fact that the case the interveners have made out by the evidence adduced before your Honor—it is not made out by the pleading. It is the case made out by the interveners.

Mr. MacKinnon: Do you want to amend to conform to proof?

Mr. Clark: Just a minute, Mr. MacKinnon. The interveners and plaintiff have made out a case, for what it is worth. Your Honor will pass on that evidence one way or the other. That is the interveners' case. Mr. MacKinnon knows very well how much of that he has to meet, and he will meet it irrespective of the condition of this pleading. There is prima facie sufficient evidence in this record to support, by inference and otherwise, all allegations of the complaint in intervention.

The Court: I certainly could not dismiss the complaint in intervention as a whole.

Mr. MacKinnon: I think you could.

The Court: I do not see much point to that.

Mr. MacKinnon: I do not either, but I would like to know [762] what we will be called upon to meet.

The Court: There was before the Court a complaint here which set forth matters which constituted a cause of action before the plaintiff's complaint was amended.

Mr. MacKinnon: I did not get that.

The Court: I said there was a complaint in intervention here which set forth a cause of action before the plaintiff's complaint was amended.

Mr. MacKinnon: That is right, but the complaint in intervention before the Court has not been sustained one iota by the proof that has been adduced.

The Court: There is as much evidence to sustain it, on the same issues, the complaint in intervention, as there is the plaintiff's complaint.

Mr. MacKinnon: On the same issue, but the same issue is not presented. I disagree with Mr. Clark on that.

The Court: Then there is no basis for dismissing the complaint.

Mr. Clark: The point is Mr. MacKinnon's move is quite adroit.

Mr. MacKinnon: The Federal Rules are very clear.

Mr. Clark: He moves to dismiss the complaint in intervention, which brought duality into the case, and then—just a minute, your Honor—once he gets rid of that, he hopes he will then make a motion to strike most of the plaintiff's case [763] because plaintiff's supplemental complaint does not go as far as their case does.

The Court: I do not want to be abrupt about this matter, but I am not going to rule on a motion to dismiss a complaint in a case of this kind where unquestionably there is a novel issue which everyone has told me exists in the case.

Mr. Clark: There is. There is no question about its being a novel case.

The Court: I will invoke a rule which I sometimes do in this type of case, Rule 12(d). Maybe you have heard of that rule. That is 12(d) of the Rules of Civil Procedure. I wrote a few decisions on it, that when there is some unusual question presented to the Court, it is foolish for any judge to try to accomplish justice by ruling on a matter that has to be determined by just what words are on paper, and until he gets a vista that the evidence gives him of what the case is really about. Both sides having had an opportunity to contribute to that, you intelligently decide whether the plaintiff is entitled to remain in court or not, and in this case the interveners. I am not going to dismiss the complaint in intervention on any ground of a more or less technical nature at this stage of the proceeding. You have a perfect right to make it. [764]

Mr. MacKinnon: I want to know what we have to meet. That is what I am more interested in than anything else.

The Court: You have a lot of lawyers sitting with you. I can see they follow the evidence in great detail. Everybody has made notes on it. You know exactly what evidence has been presented, and I do not think I have to give any advice to you as to what evidence you have to put in to meet the evidence that has been presented. You are not going to accept that compliment, are you?

Mr. MacKinnon: I will accept any compliment, your Honor. But aside from the compliments I will say this: With respect to streamlining this case, as long as the allegations remain that are here, I know of no way of streamlining it.

Mr. Clark: The allegations have nothing to do with it, your Honor.

Mr. MacKinnon: Is that statement for the record?

Mr. Clark: I say the allegations have nothing to do; the proof is in and the proof is what you will have to meet.

The Court: I do not think you necessarily have to get yourself into the frame of mind that you have to spend the rest of the year putting in a defense just because you think the Court should have granted a motion to dismiss the interveners' complaint, because you can pick out the essential things and present your evidence. You will make a better showing if you do that than if you scatter your shot. [765]

Mr. MacKinnon: That is right, but the essentials are not clear. That is one of the things that is true in this case.

The Court: You haven't got, so far as the factual record is concerned, such an awful lot to elaborate on, I do not think.

Mr. MacKinnon: No, but the written record was contemporaneous. That is the point in a nutshell. It is a contemporaneous record.

The Court: I know, you have argued that before, so has Mr. Adams, and on the cross-examination of one witness all I saw was an elaboration of some of the things. Elaboration does not necessarily mean that that proves anything more than it is an elaboration. I only suggested that in the interest of your own case, you pick out your strongest shots and shoot them—not all the shot that you may have, because sometimes it so happens when you do that, you tend to bolster up the other fellow's case.

Mr. MacKinnon: I am not afraid of that in this case. I am not remotely concerned with that. The written record that was made here was made out in the open. There is no doubt in my mind. As I said to your Honor at the inception, there is a legal question.

The Court: I do not think there is anything concealed about the case. I agreed with you on that. It is out in the open. You just pick out the things that you think fully present the whole aspects of the factual case.

Mr. MacKinnon: That is right. [766]

The Court: You do not have to go back to Adam, you do not have to lug in everything to do that. It does not necessarily follow that that adds anything. Because a man wrote four letters on the same subject does not add anything to your case, after your opponents put in one letter and you put in the other three letters, unless there is something that adds to it in some way it is just accumulative. The record does not become any more persuasive by its size.

Mr. MacKinnon: That I am convinced of. As a matter of fact, I would be very happy to make a record as brief as possible in any case.

The Court: I think the interest of justice would be best served by my reserving my ruling on your motion under 12D and you can renew it again when all the evidence is in, and then you really will be in a position to have all the ammunition with which to proceed with your argument. We will recess until tomorrow morning at 10:00 o'clock.

* * *

ALEXANDER PERRY OSBORN

called on behalf of the defendants; sworn.

The Clerk: Will you state your name to the Court.

The Witness: Alexander Perry Osborn.

Direct Examination

By Mr. Adams:

Q. Mr. Osborn, you are a resident of the city of New York? A. I am. [768]

Q. And you are one of the counsel in this case?

A. I am.

Q. You also have been for a number of years a director of the plaintiff corporation, the Western Pacific Railroad Corporation?

A. I have.

Q. When did you first become a director?

A. 1937.

Q. And you have been continuously a director since that time? A. Yes, sir.

Q. You are a graduate of Princeton, 1905?

A. Yes.

Q. And you were admitted to the bar in 1910?

A. Yes.

Q. You are also a graduate of the Harvard Law School, 1909? A. Yes.

Q. And you have been admitted to practice in the New York State and Federal courts?

A. Yes, sir.

Q. From 1910 until 1922 you were engaged in the practice of law in New York?

(Testimony of Alexander Perry Osborn.)

A. Yes, sir.

Q. And then from 1922 to 1934 you were a partner in a banking firm having its offices in New York? A. Yes, sir. [769]

Q. That was the firm of Redmond & Company?

A. Yes, sir.

Q. Thereafter, in 1934, you resumed the practice of the law? A. Yes, sir.

Q. Since that time you have been practicing law with offices in New York City? A. Yes.

Q. Will you state briefly the nature of your law practice.

A. I have been active in corporation reorganization work in connection particularly with the Chicago, Milwaukee and St. Paul Railroad Company. I have acted as a trustee for several estates, and I have done some work in connection with the qualification of securities before the Securities and Exchange Commission. I have done what we call surrogate practice work in New York, settlement of estates. Beyond that a general practice.

Q. From time to time you have been a director of various companies? A. Yes, sir.

Q. You do have a connection, do you not, with the American Museum of Natural History in New York? A. Yes, sir.

Q. Please state what that is.

A. For many years I acted as president of the corporation, and I am now First Vice President.

Q. At whose suggestion, Mr. Osborn, did you

(Testimony of Alexander Perry Osborn.)

become a director [770] of the plaintiff corporation?

A. Mr. Schumacher, who was a friend of mine, told me that Mr. Winthrop Aldrich, president of the Chase Bank, had suggested that I become a director of the corporation.

Q. At that time what interest did the Chase Bank have in the corporation?

A. The Chase Bank had loaned the corporation large sums of money and had taken bonds of the defendant railroad company as collateral for those loans, also some bonds of the Denver, Rio Grande and Western Railroad Company; so it was a large secured creditor of the corporation.

Q. And did you thereafter, while you were a director of the corporation, keep the representatives of the Chase Bank advised on the corporation's situation as the years went along?

A. Well, from 1937 to the middle of 1943, I kept them advised. By that time they had disposed of their collateral, and, as you recalled, in November, 1943, they released any deficiency judgment they might have had against this corporation.

Q. That final release took place when the agreement became effective May 1, 1944; that is the fact, is it not? A. Yes.

Q. Now, had you previously had any connection with any member of the Western Pacific group?

Mr. Clark: Previous to what date, may I ask, your Honor?

(Testimony of Alexander Perry Osborn.)

Mr. Adams: To his becoming a director. [771]

A. I was an assistant lawyer in a case involving the inheritance tax of Mr. Arthur Curtis James' father, but it seems that is rather a far cry from having a connection with any members of this group.

Q. That is Mr. D. Willis James?

A. D. Willis James.

Q. That was way back when? A. 1910

Q. Aside from that you haven't had any connection? A. I don't recall any.

Q. Aside from that connection have you ever had any connection, in a business or professional way, with A. C. James or any of his interests?

A. Well, I also had one matter involving negotiations by the Phelps Dodge Corporation, in which Mr. James had a large interest, but it was wholly collateral with this issue.

Q. It had no connection in any way with the Western Pacific?

A. No, none whatsoever.

Q. And about when did that take place?

A. Perhaps 1939; I can't place it exactly.

Q. Now, during the time you have been a director of the corporation have you at all times sought in your office as director to protect the interests of the corporation to the best of your ability?

A. Yes, sir. [772]

Q. You were for a time a director of and a member of the executive committee of the Western

(Testimony of Alexander Perry Osborn.)

Pacific Railroad Company; is that not the fact?

A. That is the fact.

Q. And in those capacities, is it the fact that your directorship and membership in the executive committee came to an end in November of 1944?

A. That is correct.

Q. That was prior to the time when the reorganization trustees returned the property to the reorganized railroad company, is it not?

A. Yes, sir.

Q. And at whose suggestion did you become a director and member of the executive committee of the railroad company? A. Mr. Schumacher's.

Q. Did you ever attend, as far as you can recall, any meeting of the directors of the railroad company?

A. I don't recall attending any meeting of the railroad company.

Q. Do you recall ever attending any meeting of the executive committee? A. No, I do not.

Q. It is true, is it not, Mr. Osborn, that this directorship in the railroad company—that is, yours—was simply an outgrowth or incident of your directorship in the corporation? [773]

A. I believed it to be.

Q. And that applied likewise to your membership in the executive committee? A. Yes, sir.

Q. And it is true, is it not, that your positions as director and member of the executive committee of the railroad company while you occupied those

(Testimony of Alexander Perry Osborn.)

positions did not affect in any way your loyalty to the corporation as a director of that corporation?

A. That is true.

Q. Have you ever had any position with the reorganized railroad company? And by that I mean the railroad company from and after January 1, 1945? A. No, sir.

Q. Now, Mr. Osborn, did you attend the meetings of the directors of the plaintiff corporation regularly? A. Yes.

Q. Did you see Mr. Schumacher on those occasions?

A. He usually attended the meetings.

Q. And did you also see him on other occasions?

A. I saw him at the time of the meetings, and occasionally outside, in between the meetings.

Q. Would you say that in the course of the years you were a director, you have been a director of the plaintiff corporation, you became well acquainted with Mr. Schumacher? [774]

A. Yes, I was well acquainted with him, and he was a very good friend of mine.

Q. Are you familiar with Mr. Schumacher's reputation as a businessman and a railroad executive? A. Yes, sir.

Q. Please state what his reputation was in those respects.

A. A man of great ability and great honesty of character.

Q. Now, according to your observation of Mr.

(Testimony of Alexander Perry Osborn.)

Schumacher's conduct as president and director of the plaintiff corporation, you recall he was president until 1942 and remained as a director, was he, according to your observation, at all times devoted to the corporation's interests?

Mr. Phleger: I am going to object to that as calling for this witness' conclusions, also irrelevant, incompetent and immaterial.

Mr. Adams: I will submit the question, your Honor. I asked the witness according to his observation. He was a fellow director and he said he knew Mr. Schumacher well.

Mr. Phleger: The fact is, the facts show that Mr. Schumacher during this period was a trustee of the company.

Mr. Adams: You knew that quite well, did you not?

A. I knew he was a trustee of the property, and also——

Q. Thank you. Yes. That is accurate.

The Court: Well, what is it that you were getting at? You mean was he devoted to the corporation? [775]

Mr. Adams: I am endeavoring, your Honor, to meet the contentions based upon duality, and the interveners' contentions with respect to domination and control. I believe under the cases and authorities that where a dual relationship is established, as a matter of fact, it is appropriate to inquire as to the conduct of the gentlemen who occupied such positions.

(Testimony of Alexander Perry Osborn.)

Mr. Clark: There is no contention in this case, your Honor, that the court's trustees were dominated or controlled in the least.

Mr. Adams: I am happy to have that concession.

Mr. Clark: Well, that concession was made on pre-trial.

Mr. Adams: The contention, as I understand it, is this, your Honor. The James interests dominated and controlled the plaintiff corporation.

Mr. Adams: Now, Mr. Schumacher was one of the officers of the plaintiff corporation.

The Court: Oh, that isn't what is concerning me; it is the form of your question. You asked him whether a man was devoted to the company. Suppose he says "Yes" to that. What is that going to mean to you?

Mr. Adams: I will reframe the question, your Honor.

Q. According to your observation of Mr. Schumacher's conduct during the times he was president and director of the corporation, Mr. Osborn, would you say that he had conducted himself at all times in that capacity diligently in looking after the [776] corporation's interests? A. Yes, sir.

Q. During the period you have been on the board of directors of the corporation has Mr. Willis D. Wood also been a member of that board?

A. Yes, sir.

Q. What was Mr. Wood's occupation?

A. Mr. Wood is a retired businessman. He was

(Testimony of Alexander Perry Osborn.)

active in a banking and securities firm in New York, a partner in that firm. The firm specialized in railroad securities. He is a member of the board, the board of directors, of the Missouri, Kansas and Texas Railroad Company, and member of the boards of several large insurance companies in New York. He is interested in a number of philanthropies in New York.

Q. And do you know Mr. Wood's reputation?

A. I do.

Q. Will you please state it.

Mr. Clark: We object to that, your Honor, upon the ground it is incompetent, irrelevant and immaterial and calls for the conclusion of this witness.

Mr. Adams: Your Honor, the suggestions about duality may be met, among other ways, by way of showing who the people were and of what substance they were. We have heard it pointed out with a great deal of repetition that one of these gentlemen was what the plaintiffs call a stenographer. Now I am [777] asking about Mr. Wood.

Mr. Clark: Well, we will withdraw the objection.

The Court: All right.

A. Mr. Wood was a man of very excellent reputation in every respect.

Q. (By Mr. Adams): Now, according to your observation, did Mr. Wood conduct himself in his actions as director of the corporation, as an independent director, looking after the corporation's best interests? A. Yes, sir.

(Testimony of Alexander Perry Osborn.)

Q. Do you know Mr. H. Brua Campbell?

A. I do.

Q. And he was during a portion of this time a director of the plaintiff corporation?

A. He was.

Q. Mr. Campbell was a partner in the law firm of Pierce & Greer during that time also, was he not? A. I understood that was the case.

Q. From your observation of Mr. Campbell's conduct as a director would you say that he was an independent director looking after the best interests of the corporation?

A. That was my observation.

The Court: Campbell was a director of the corporation?

Mr. Adams: Yes, your Honor.

Mr. Clark: As well as a partner in Pierce & Greer. [778]

Mr. Phleger: And general counsel for the defendant company.

Mr. Clark: In New York.

The Court: Was he a director of the company, too?

Mr. Adams: He was.

Mr. Phleger: Here he is right here (indicating on chart).

Mr. Clark: Yes, and he was also a director of the railroad company for a time, your Honor, and the exhibits show that.

Mr. Adams: I believe that is correct.

(Testimony of Alexander Perry Osborn.)

Mr. Phleger: He was also general counsel for the railroad company.

Mr. Clark: And the railroad corporation.

Mr. Adams: We will get those facts established.

The Court: You can make that point in your argument. The chart does not show him as a director of the corporation.

Mr. Phleger: Not during this period, no—yes, he was.

Mr. Clark: Yes, he was a director of the corporation. Yes, he was a director, and the annual reports show it. The chart in evidence shows all of that, your Honor.

The Court: Very well.

Q. (By Mr. Adams): You knew, of course, that Mr. Schumacher was a trustee in the reorganization? A. I did.

Q. Is it the fact that your fellow directors on the board of directors were also familiar with that?

A. I believe they were.

Q. During the period that you have been a director, has the firm of Pierce & Greer and Mr. Frank C. Nicodemus, Jr., a member of that firm, been the counsel of the plaintiff corporation?

A. They have.

Q. And you are, of course, well acquainted with Mr. Nicodemus? A. Yes.

Q. And I take it that it is within your knowledge to state that Mr. Nicodemus and Mr. Schumacher were very close associates?

(Testimony of Alexander Perry Osborn.)

A. Well, Mr. Nicodemus acted as counsel for Mr. Schumacher.

Q. Perhaps I did not put that just the right way. What I have in mind is you and your fellow directors were aware, of course, that Mr. Nicodemus and Mr. Schumacher were very well acquainted?

A. Oh, yes.

Q. You knew, did you not, that during the period of trusteeship Mr. Nicodemus represented the debtor in this reorganization proceeding?

A. Yes.

Q. And by "the debtor" we mean the Western Pacific Railroad Company which went into bankruptcy? A. Yes.

Q. And you also knew, did you not, that Mr. Nicodemus was from time to time advising Mr. Schumacher on trustees' problems? A. I did.

Q. It was your understanding, I take it, that he was not [780] officially an attorney to the trustees, that position being occupied by their counsel, but that he was advising Mr. Schumacher personally from time to time upon trustees' problems?

A. I though he was.

Q. That was your understanding?

A. That was my understanding. [781]

* * *

Q. Mr. Osborn, you are aware, of course, of the claim the corporation had against the Railroad Credit Corporation arising out of the reorganization? A. Yes.

(Testimony of Alexander Perry Osborn.)

Q. Was Mr. Nicodemus active in asserting those claims? A. He was.

Q. Is that likewise the case with regard to the claims of the corporation against the Reconstruction Finance Corporation [785] arising out of the reorganization? A. Yes.

Q. It is likewise the fact with regard to the claims that the corporation is now pressing against the Sacramento Northern? A. Yes, sir.

Mr. Adams: One aspect of which was before your Honor recently and your Honor made a ruling upon an order that Judge St. Sure had previously made.

The Court: Yes.

Q. (By Mr. Adams): To your knowledge, Mr. Osborn, has Mr. Nicodemus ever failed to assert a claim of the corporation?

Mr. Clark: Just a minute. I will object to that upon the ground it calls for the opinion of the witness. It is incompetent, irrevelant and immaterial.

Mr. Adams: It is a question as to the knowledge of the witness.

The Court: Read the question.

(Question read.)

Mr. Clark: It is vague and indefinite, too.

Mr. Phleger: Beyond that, this is based upon Mr. Nicodemus having knowledge of claims. What claims?

Mr. Adams: I think Mr. Phleger's suggestion is good.

(Testimony of Alexander Perry Osborn.)

The Court: Ask him if there was any action the corporation requested him to take which he refused or failed to take.

Mr. Adams: Thank you, your Honor. May I ask if Mr. Osborn [786] would answer that question?

The Witness: I know of no instance in which he failed to perform his duty or respond to a request of the corporation.

Q. (By Mr. Adams): Do you know of anything, Mr. Osborn, that existed to prevent Mr. Nicodemus from asserting the present claim now being heard in this court during the reorganization if he had known about it?

Mr. Phleger: I object to that.

The Court: That is pretty hypothetical.

Mr. Phleger: It calls certainly for the opinion of this witness.

The Court: Would you read the question.

(Question read.)

Mr. Clark: Hypothetical, argumentative.

The Court: I think that is irrelevant. I will sustain the objection.

Q. (By Mr. Adams): It is the fact, is it not, Mr. Osborn, that as a director of the corporation you know that the New York office was a joint office of the plaintiff corporation and the railroad company? A. Yes, sir.

Q. Did you see anything inappropriate or unusual in that arrangement? A. I did not.

(Testimony of Alexander Perry Osborn.)

Q. You knew, did you not, that during the period prior to June [787] 1943 the expenses of that office were paid in part by the plaintiff corporation and in part by the reorganization trustees?

A. I knew that.

Q. And did you consider that that arrangement was in any way inappropriate or disadvantageous to the plaintiff corporation? A. No.

Q. Now, the record here shows that in June of 1943, the beginning of that time and continuing until the New York office was closed—strike that.

I had better state the record more accurately. The record here shows that beginning June 1, 1943, and until the end of 1944, which was the end of the trustees' operations, the entire expense of the New York office was paid by the reorganization trustees; that then that office remained opened for a period of four months, and during that period of four months those expenses were paid by the reorganized railroad company.

Now, when, if you recall, Mr. Osborn, did you learn about the arrangement for the reorganization trustees to take over the whole expense of the New York office?

A. Contemporaneously with the facts.

Q. Did you then see anything inappropriate about that arrangement? A. No.

Q. Did you see anything in that arrangement at that time that you considered disadvantageous to the plaintiff corporation? [788] A. No.

(Testimony of Alexander Perry Osborn.)

Q. The New York office was the head office of the Western Pacific group, was it not?

A. Yes, sir.

Q. And did the board of directors of the corporation determine policy in regard to Western Pacific matters?

Mr. Phleger: Now, just a moment. What do you mean by "Western Pacific"? Do you mean railroad matters?

Mr. Adams: I mean with regard to all Western Pacific interests that the plaintiff corporation had. Does that characterize it?

Mr. Phleger: Do you mean did the directors of the plaintiff corporation determine its policies?

Mr. Adams: I think that is what it comes down to, so I am persuaded to withdraw the question; I think it is self-evident.

The Court: Yes, I think so.

Q. (By Mr. Adams): Now, Mr. Osborn, do you recall that on March 15, 1943, the Supreme Court approved the Interstate Commerce Commission's plan of reorganization? A. Yes, sir.

Q. And what was your judgment as a director at that time of the effect of the decision on the plaintiff corporation?

A. I thought it ended the interests of the corporation in the railroad company. [789]

Q. You thought it was substantially a final decision against the plaintiff's equity?

A. It seemed so to me.

(Testimony of Alexander Perry Osborn.)

Q. That was your understanding?

A. It seemed so to me.

Q. And do you know whether or not the board of directors had the same view?

Mr. Phleger: The minutes are in evidence, I think, on that question.

A. Yes, they had the same view.

Q. (By Mr. Adams): Now, Mr. Osborn, prior to October of 1946, which is the time when this lawsuit here was instituted, did you ever suggest to Mr. Polk or Mr. Coulson that either of them had any obligation to advise the plaintiff corporation of possible claims against other group members on account of the tax transactions?

A. Would you mind reading that to me?

(Question read.)

A. No.

Q. And prior to that time, October of 1946, did Mr. Polk or Mr. Coulson ever refuse to provide you with any information which you asked of them in connection with the tax transactions?

Mr. Phleger: Well, now, that assumes that he asked them.

The Court: Yes, it is a little double-barreled, Mr. Adams.

Q. (By Mr. Adams): Is it the fact that you did make inquiry, [790] Mr. Osborn, about the tax transactions?

A. I made no inquiry of Mr. Polk and Mr. Coulson.

(Testimony of Alexander Perry Osborn.)

Q. I see. So that no occasion ever arose of the possibility of their either furnishing or declining to furnish any information?

Mr. Phleger: Now, I object to that because it assumes a very important fact that your Honor will have to pass on, as to what the obligations of attorneys are about advising their clients. He is asking this man whether or not he asked the attorneys to advise them. How about the attorneys being under an obligation themselves to advise?

The Court: Well, I think that the answer that he didn't make any inquiries disposes of that.

Q. (By Mr. Adams): Now, do you recall the corporation receiving advice in April, 1947, that a settlement proposal had been made to the Bureau of Internal Revenue with regard to these tax matters? A. Yes, sir.

Q. And were you advised at that time of the terms of the settlement proposal?

A. Well, I was advised in the sense that we received a letter, which Mr. Curry presented to the board—a letter, I think, from Mr. Polk—that outlined the terms of the proposed settlement. [791]

* * *

Q. (By Mr. Adams): Now, Mr. Osborn, you have before you Plaintiff's Exhibit 68?

A. Yes, sir.

Q. Consisting of a letter addressed by Mr. Curry to Pierce & Geer of April 4, 1947, and enclosures, and you note that the letter itself shows, "Copy,

(Testimony of Alexander Perry Osborn.)

Mr. A. Perry Osborne, 20 Exchange Place, New York 5, New York"? A. Yes, sir.

Q. And does that refresh your recollection that you received a copy at that time?

A. I remember seeing the copy of the letter of Mr. Polk to Mr. Curry at that time, yes—receiving that.

Q. And that is a portion of Plaintiff's Exhibit 68, being a copy of the letter of April 4, 1947, and marked also 41-B to -D? [792]

A. That is correct.

Q. Now, then, you notice also that Plaintiff's Exhibit 68 includes, as an enclosure, the pages marked 41-E to -F? A. That is correct.

Q. Being a copy of a letter signed, "Western Pacific Railroad Corporation, James K. Polk, Attorney in Fact," and dated February 11, 1947, addressed to the Hon. Joseph D. Nunan, Jr., Commissioner of Internal Revenue? A. Yes, sir.

Q. And when I asked you the question that I did a moment ago, and you answered the question regarding your receiving advice that a settlement proposal had been made to the Bureau of Internal Revenue, were you referring to the advice shown upon Plaintiff's Exhibit 68? A. Yes, sir.

Q. Thank you. You may look at that further if you wish to do so. A. Yes.

Q. You knew, did you not, Mr. Osborn, at that time that the plaintiff corporation was free to accept or to reject the settlement proposal as it might see fit? A. Yes, sir.

(Testimony of Alexander Perry Osborn.)

Q. Now, strictly from the standpoint of the settling of the matter with the Government for taxes for the period in question, did you consider that the settlement was a good one—and I [793] am leaving out of my question anything about the intercorporate claims? A. Yes, sir.

Q. Was that the judgment of your fellow directors?

A. It was the judgment of the committee that was appointed to consider the matter.

Q. And the committee consisted of yourself, Mr. Wood and Mr. Nicodemus?

A. That is correct, and Mr. Curry as ex officio.

Q. And Mr. Curry, ex officio. Now, is it the fact that nevertheless, notwithstanding your view about the advisability of a settlement as regards the Government, that the directors seriously considered withdrawing Mr. Polk's power of attorney and refusing to go along with the settlement?

A. They certainly considered that.

Q. And what was their reason for considering that?

A. The reason, I believe, was the desire of the corporation to have the matter submitted, the question of the claim of the corporation, as a legal and equitable matter before some competent court, and because of the inability to have that done, because of the answers which the defendant made, which raised technical objections to that course—and our position was that those technical defenses should

(Testimony of Alexander Perry Osborn.)

be withdrawn and the claim should be submitted as a matter for legal and equitable determination.

Q. And by "technical defenses" you have reference particularly, do you not, to the defense that the reorganization proceeding is a bar?

A. That is correct, sir. And the other technical defenses, the statute.

Q. Statute of limitations?

A. And delay of the corporation in asserting the claim.

Q. Now, the board finally took the position, did it not, that the settlement with the Government should be approved? A. It did, yes.

Q. But in connection with doing that, the board had, prior to that time, obtained an agreement for a stipulation which is the stipulation that was afterwards filed with the court; is that the fact?

A. That is correct.

Q. Yes.

The Court: Well, that is the stipulation that was made which made it possible to make a settlement without anybody waiving any claims in regard to subsequent litigation?

Mr. Adams: That is correct.

Mr. Clark: That is the time we came in with an application for injunction.

Q. (By Mr. Adams): Now, so far as you can see, Mr. Osborn, was the corporation in any way prejudiced by reason of the fact that it obtained notice of the settlement in April, 1947, [795] in-

(Testimony of Alexander Perry Osborn.)

stead of February, 1947, when the settlement was proposed?

Mr. Phleger: Well, I object to that as calling for the conclusion of the witness, a legal matter.

Mr. Adams: This is a director of the plaintiff corporation.

Mr. Phleger: It doesn't make any difference. That may be one of the questions.

The Court: That may be true, but what is the materiality of asking his opinion concerning that?

Mr. Adams: I understand that contentions are to be made here that in some fashion or other, which I am frank to say I do not understand at all, there was some prejudice to the corporation derived from the fact that the settlement proposal was first made in February, 1947, but the corporation wasn't advised about it until April, 1947. Now I am asking one of the directors of the corporation, who participated in the transactions, if there was any prejudice to the corporation resulting from that delay.

The Court: Well, that would be a legal question, if it were material.

Mr. Phleger: But perhaps I can help counsel. We introduced evidence of that not for the purpose at all of showing prejudice to the plaintiff corporation; we introduced it for this purpose: and it is absolutely and conclusively proof of it—that the matter was taken over and handled by the [796] defendant, namely, the defendant made all of the decisions with respect to this offer of settlement

(Testimony of Alexander Perry Osborn.)

and the negotiations of settlement, without even advising the plaintiff corporation. That is our point. They passed these letters in April 2; they communicated with San Francisco, the directors of the defendant in San Francisco met, authorized them. And it wasn't until April, three months later, that this corporation was advised for the first time.

Mr. Clark: You mean the letters passed on February 11, Mr. Phleger, not April 2.

Mr. Phleger: Yes; well, I mean the letter to the plaintiff corporation was in April.

* * *

Q. Mr. Osborn, when and where did you first meet Colonel Coulson?

A. I met him at my first attendance at the board meeting of the corporation; I think it was in early 1937.

Q. And he was then a director of the plaintiff corporation? A. Yes, he was. [797]

Q. Now, you know, of course, that throughout the reorganization proceedings Mr. Coulson was the attorney for the A. C. James Company, and in those proceedings? A. Yes, sir.

Q. And you knew, of course, that throughout the period he was a director and thereafter that Mr. Coulson and his firm have been attorneys for the James interests? A. Yes, sir.

Q. And for Mr. Arthur Curtis James personally while he was living? A. Yes, sir.

(Testimony of Alexander Perry Osborn.)

Q. Did you ever do any legal work for Colonel Coulson or for his firm? A. No, sir.

Q. Did you ever do any legal work for Mr. James or his companies? I will list them very quickly: the A. C. James Company, the Curtis Southwestern Corporation, the Curtis Southwestern Company, the James Foundation of New York, Inc. Did you ever do any legal work for any of those interests, other than the two incidents you have spoken of, one of them relating to D. Willis James and the other relating to the Phelps Dodge matter?

A. No, sir.

Q. Now, when you were asked to become a director of the plaintiff, were you told that you were to represent any interest other [798] than the general interest of its stockholders? A. No, sir.

Q. During the period of your service as a director of the plaintiff corporation, have you ever been told how you should vote on matters coming before the board of directors? A. No.

Q. Did any representative of the James interests ever request you to vote for or refrain from voting on any matter coming before the board?

A. No, sir.

Q. Were you yourself dominated or controlled in the discharge of your duties as a director by any representative of the James interests?

A. No, sir.

Q. And is the same answer to be given with respect to the Colonel Coulson?

(Testimony of Alexander Perry Osborn.)

A. You mean as to whether he——

Q. Dominated or controlled you in your conduct as a director. A. Not whatsoever.

Q. During the period of your directorship, did you keep yourself informed with regard to the affairs of the plaintiff corporation?

A. Yes, sir.

Q. And did you exercise your best judgment on matters coming before the board during that period? [799] A. Yes, sir.

Q. Were you afforded as a director full opportunity to discuss matters coming before the board?

A. Yes, sir.

Q. And that is likewise true as to all other members, is it not, of the board? A. I thought so.

Q. And did the directors freely discuss matters that came before them? A. Yes, sir.

Q. Did any representative of the James interests ever ask you to refrain from bringing up any matter for consideration before the board?

A. No.

Q. Now, I have asked you a number of questions about the James interests. Is the same thing true as regards the defendant railroad company? That is, to put it generally, did any representative of the defendant railroad company at any time——

Mr. Adams: Now, just a moment, your Honor. May I think out loud about this? I think I am asking something not in issue. I think the interveners' contentions of domination and control as be-

(Testimony of Alexander Perry Osborn.)

tween the trustees and the plaintiff corporation, as between the defendant railroad company and the plaintiff corporation, assuming the subsidiary could control a parent—I think all such contentions have been withdrawn. I understand there [800] is still a contention——

* * *

Mr. Adams: ——on the part of the interveners that the James interests dominated and controlled the parent corporation. That completes my statement.

Mr. Clark: That is correct.

Mr. Phleger: I might, for the purpose of clarification, say that our contention very definitely is that the trustees when in office and the corporation after it succeeded to these properties, took over and handled and managed these tax matters.

Mr. Adams: Well, may I ask Mr. Phleger——

Mr. Phleger: I mean the company; excuse me.

Mr. Adams: May I ask Mr. Phleger just to clear that up?

Mr. Phleger: I don't suggest by that that there is anything invidious about domination, but they just did. They ran it, made the decisions.

Mr. Adams: Well, I am just seeking to find out what the contention is, because I have to ask the witness some questions.

Mr. Phleger: Yes.

Mr. Adams: Now, it has been my understanding that there is no contention that the reorganization

(Testimony of Alexander Perry Osborn.)

trustees dominated or [801] controlled the plaintiff corporation. Is that a fact?

Mr. Phleger: I think my position is absolutely clear. Mr. Schumacher was a trustee and Mr. Curry was Mr. Schumacher's man. Now, I don't predictae anything upon that at all, but that is a fact that is in this record. The evidence we produced was directed to the proposition that these tax matters were handled by the defendant corporation, and the decisions made by it. Now, I don't characterize that as anything except just that.

* * *

Q. Mr. Osborn, did the trustees in reorganization or either of them to your knowledge at any time instruct you as to how you should act?

A. No, sir.

Q. As a director? A. No, sir.

Q. And they never at any time told you how to vote or what to say or in any way interfered with free exercise of your judgment as a director, is that correct? [802] A. That is correct.

Q. Did the trustees or either of them at any time to your knowledge give any instructions or directions to any member of the board of directors of the corporation as to how to conduct himself or the corporation's affairs?

A. I never heard of any instructions being given.

Q. And it is the fact, is it not, that you were, as a director, not in any wise dominated or controlled in the discharge of your duties by the court's

(Testimony of Alexander Perry Osborn.)

trustees, either of them or any representative of those trustees?

* * *

A. I was not.

Q. (By Mr. Adams): During the period of your services as a director of the plaintiff corporation did any representative of the James interests at any time ask you to pursue a course of conduct in the special interest of Mr. James or his companies? A. No, sir.

Q. During the period of your service at any time as a director of the plaintiff did Colonel Coulson at any time ask you to pursue any course of conduct in the special interest of the [803] James interests?

A. No, sir.

Q. I have been speaking of the James interests generally, and would the answers that you have given me with regard to the questions I have asked as to anyone offering to give you any advice or instructions as to how you should act or in any way interfering with your term as a director; would those answers to those questions be the same if I were to ask you whether any officer or trustee of the James Foundation sought to interfere with your conduct as a director?

A. I can't exactly answer that question. I think advice was given, but the question was whether the advice was solid.

Q. Let me ask these questions: Did any officer or trustee of the James Foundation ever tell you

(Testimony of Alexander Perry Osborn.)

how you should vote on matters coming before the board? A. No, sir.

Q. Or tell you to refrain from voting on any matters coming before the board? A. No, sir.

Q. Or tell you who should be selected as officers of the plaintiff corporations? A. No, sir.

Q. Or tell you who should be selected as directors of the plaintiff corporation?

A. No, sir.

Q. Or tell you how in any respect you should conduct yourself as a director of the plaintiff corporation? A. No, sir.

Q. Did you as a director of the plaintiff ever consciously act in the interest of the James Foundation to the detriment of the plaintiff corporation of which you were a director? A. No, sir.

Q. Did you vote for the election of Mr. Curry as president of the plaintiff corporation in January, 1942? A. I did.

Q. And in casting your vote did you exercise your best judgment as you saw it in the interests of the plaintiff corporation? A. I did.

Q. And after his election as president, I take it Mr. Curry was the presiding officer at the meeting of the board of directors? A. Yes, sir.

Q. During the period of your directorship you were aware, were you not, that Mr. Curry received compensation from the reorganization trustees?

A. I was not aware that his compensation came from the reorganization trustees. I knew that at

(Testimony of Alexander Perry Osborn.)

one time he was receiving compensation from the corporation, from the company, and after June, '43, wasn't it, he received his compensation from the company exclusively, and that lasted until the New York office was closed, and thereafter I knew that he was receiving some [805] pension from the company and also some compensation from Colonel Coulson's firm.

Q. When you speak of receiving compensation from the company in 1943 and 1944, I take it you had no purpose to insist that the company was not then in reorganization? A. Oh, no.

Q. Did you as a director of the plaintiff corporation disapprove of Mr. Curry's receiving a retainer from the firm of Whitman, Ransom, Coulson & Goetz? A. No, sir.

Q. The fact is, is it not, Mr. Osborn, that at or about the time of closing the New York office you discussed with Mr. Schumacher and Mr. Coulson the idea of doing something for Mr. Curry in view of his pending retirement?

A. Yes, sir, without indicating who should do it or what should be done; I just said I thought he ought to be taken care of.

Q. Precisely.

The Court: During the time that you were director of the corporation in 1943 and 1944 did the directors ever discuss the filing of these consolidated tax returns at or about the time they were filed?

The Witness: No, sir. [806]

* * *

(Testimony of Alexander Perry Osborn.)

Q. (By Mr. Adams): Mr. Osborn, you said you have been a director of a number of corporations?

A. Yes, sir.

Q. Would you say that was ten or more?

A. You asked me to prepare a list.

Q. I am just asking you for an approximate number. I do not want to go into detail unless that is necessary.

A. According to the list prepared by my secretary it is seventeen in all.

Q. Was the matter of the income tax returns ever taken up at any board meeting of any corporation of which you were a director?

* * *

Q. (By Mr. Adams): Mr. Osborn, during all the time you were a director of the Western Pacific Railroad Corporation, were the income tax returns ever taken up with the Board of Directors?

* * *

The Witness: As the question is put, it is very hard to answer. May I answer the question in my own way?

Q. (By Mr. Adams): Answer it according to your best recollection.

A. My best recollection is that the income tax returns were not taken up with the Board of Directors at any time prior to June, 1946, when the suit, the VanKirk action, was filed, nor was there any discussion of income tax returns in the Board of Directors.

(Testimony of Alexander Perry Osborn.)

Q. Mr. Osborn, until you learned of the institution of the stockholders' action in New York in the middle of 1946 and of the claims stated in that action, had the thought ever occurred to you of the plaintiff having any claim on account of the benefits to the court's trustees or the railroad company in these consolidated returns? A. No, sir.

* * *

Q. (By Mr. Adams): Prior to that time when you learned of the claims advanced in the stockholders' action in New York, had any officer or director of the plaintiff stated to you that he [808] thought or considered that the plaintiff corporation had any rights rising out of the benefit to the court's trustees of the railroad company in these consolidated returns? A. No, sir.

Q. You had heard no such suggestion from anyone prior to that time? A. No, sir.

Q. You knew, did you not, during the years 1943, 1944 and 1945 that the holding company was filing consolidated income tax returns?

A. Yes, sir.

Q. And you know, did you not, that the consolidated returns included the operations of the railroad in the hands of the court's trustees?

A. Yes, sir.

Q. And you know, did you not, that there were substantial, large advantages in respect of the taxes upon the income of the railroad incident to these consolidated returns?

(Testimony of Alexander Perry Osborn.)

A. I knew there were benefits in filing consolidated returns which the railroad company would secure and I have testified that I knew they were substantial benefits, I think, but I had no knowledge of what the benefits were.

Q. It is the fact, is it not, Mr. Osborn, that you knew that there were large and substantial benefits to the taxes upon the railroad's income derived from these consolidated returns filed [809] by the holding company?

A. I had no knowledge of what the benefits were. I thought there were benefits and I testified that they were substantial benefits.

Q. Let me ask you this to refresh your recollection: Turn to page 4239 of the record of your deposition taken in this action. In fact, being at the bottom of page 4238, if you will, two lines from the bottom. Will you follow as I read, it Mr. Osborn?

A. Yes, sir, 4238?

Q. 4238, at the bottom. A. Yes.

Q. "Q. At the time of the filing of the consolidated returns for 1943 and 1944 did you know that there were large tax benefits to the railway company in the filing of the consolidated return?

"A. I knew there were benefits to the railroad company from the filing of consolidated returns.

"Q. In connection with the last question and the last answer I read the following question and answer from the transcript of your testimony upon the taking of your deposition in February, 1947, in the New York stockholders' suit."

(Testimony of Alexander Perry Osborn.)

A. Mr. Adams, excuse me. What page are you reading from?

Mr. Clark: There was a mistake in the page. It was 4239, [810] Mr. Osborn. I think counsel mentioned 4238. It is 4239.

Q. (By Mr. Adams): I began at the bottom of page 4238, two lines from the bottom and I am continuing on page 4239. My copy shows that that is what I am doing.

A. I am now looking at page 4239.

Q. Have you had any trouble about that?

A. No, I was looking at 4238 before.

Q. I said I was beginning at the bottom of that page.

A. Yes, but I was not following you. Now I am following you.

Q. Then beginning with a question, "in connection with the last question—" do you have that?

A. I have that, yes.

Q. "Q. In connection with the last question and the last answer, I read the following question and answer from the transcript of your testimony on the taking of your deposition in February, 1947, in the New York stockholders' suit, upon examination by counsel for the plaintiff stockholders page 343, bottom:

"Q. Did you know that contemporaneously with the filing of the 1943 and 1944 consolidated return?

"A. (At the top of page 344.) Only as a matter of general knowledge that there were large tax

(Testimony of Alexander Perry Osborn.)

benefits to the railroad company in the filing of this consolidated return.' [811]

"Q. Did you give that testimony at that time?

"A. I believe I did.

"Q. Was it true?

"A. I can only say this, that I cannot specify what I had in mind as to what the large benefits were.

"Q. May I have an answer to my question?

"Mr. Dickerson: I do not think that his testimony is inconsistent, Mr. Adams.

"Mr. Adams: I did not ask anything about inconsistency. I asked if the testimony was true. I would like to have an answer to my question.

"The Witness: I am sure I thought it was true at that time."

Do you recall that I asked those questions and you gave those answers at that time?

A. Yes, sir.

Q. Were the answers which you gave then upon the taking of your deposition true?

A. Yes, sir.

Mr. Adams: No further questions, your Honor.

Cross-Examination

By Mr. Phleger:

Q. Mr. Osborn, when did you first learn of the fact that the plaintiff's stock loss had been utilized in a consolidated return? A. June, '46. [812]

Q. In June of '46. That is long after the period of the filing of these tax returns?

(Testimony of Alexander Perry Osborn.)

A. Yes, sir.

Q. When did you first learn that a claim for the refund of the 1942 taxes had been filed? That was filed on March of 1945.

A. April of 1947.

Q. April of 1947, two years later. When did you first learn that a power of attorney had been given by the plaintiff corporation to Mr. Coulson's firm to represent him in this matter, the power having been given on June 26, 1946?

A. April, 1947.

Q. About a year later?

A. About a year later.

Q. In your practice do you deal with income tax matters, that is, are you an income tax man?

A. No, sir.

Q. Have you any general knowledge about consolidated returns or the tax incident to that? [813]

* * *

The Witness: What is the question?

The Court: He wants to know how much you know about affiliated corporation returns, if any. That is what the lawyers always say, "if any."

A. I have no real knowledge as a lawyer of the filing of corporate consolidated tax returns. I have never acted for any corporation in that respect.

Q. (By Mr. MacKinnon): I beg your pardon?

A. I have never acted for any corporation in that respect. [814]

* * *

(Testimony of Alexander Perry Osborn.)

Mr. MacKinnon: Will you read the question? Is it a question before the witness?

The Court: I said I took it your question was whether or not the witness had any knowledge of income tax matters having to do with consolidated corporate returns.

Q. (By Mr. Phleger): Will you answer that?

A. I had no such knowledge.

The Court: I suppose that is what you mean—I am not intending to interrupt either examination—what you are inquiring about is whether the witness has any professional knowledge concerning the matter?

Mr. Phleger: That is correct.

The Court: Trained himself or has special qualifications. [815]

Mr. MacKinnon: I see no objection to that.

Q. (By Mr. Phleger): Will you answer that?

A. What was the question now? I have had no professional experience in corporate taxation.

Q. (By Mr. Phleger): You have testified that you did not hear of the use of the loss of the plaintiff corporation in the consolidated return until June of 1946? A. That is correct.

Q. Will you state what the occasion was?

A. The occasion was the bringing of the two VanKirk actions, one in the States Supreme Court and one in the District Court in New York, in June of 1946. And I either heard of these actions and the claim therein stated from Mr. Nicodemus in

(Testimony of Alexander Perry Osborn.)

connection with the action, he being counsel for the corporation at that time, or I got the knowledge independently by receipt of the complaints in that action at or about that time. But I am unable to state whether I heard it from Mr. Nicodemus in connection with the actions or from the actions themselves.

Mr. Phleger: That is all.

Cross-Examination

(For Interveners)

By Mr. Clark:

Q. Mr. Osborn, was the matter of the corporation giving Mr. Polk and his associates a power of attorney on June 26, 1946, over presented to the directors of the plaintiff corporation?

Mr. MacKinnon: I object to that—— [816]

Mr. Phleger: He has stated that he didn't hear about it.

Mr. Clark: He said if he didn't hear about it, and it is a preliminary question anyway.

Q. (By Mr. Clark): Now, Mr. Osborn——

A. I just answered that question. But if you want me to answer it——

Q. I thought it was answered.

A. Will you read the question? How did you put that question?

Mr. Clark: May I have it read?

The Court: There was a question and answer and then an objection.

(Testimony of Alexander Perry Osborn.)

Mr. MacKinnon: My objection to it is that it is not the best evidence. Defendants will show what was what.

Mr. Clark: You will concede, won't you, that the minutes show no such thing?

Mr. MacKinnon: You have them.

Mr. Clark: We are trying not to encumber this matter. I thought the same sort of question was asked by Mr. Adams.

Mr. Adams: No, your Honor, I asked the director——

The Court: Well, then, it was an argumentative statement of counsel.

Mr. Clark: No, may it please your Honor, Mr. Adams asked whether the matter of consolidated returns had ever been discussed, or presented to the Board of Directors, and the answer was "No." Now I am directing this specifically to the power of attorney [817] which was given by the plaintiff corporation to Polk on June 26, 1946.

The Court: He may answer it, or if he hasn't——

Q. (By Mr. Clark): Was the matter presented to the Board of Directors? A. It was not.

Q. Do you remember any prior occasion, in prior years, Mr. Osborn, when the matter of the corporation, the plaintiff corporation, getting Mr. Polk and his associates at the time at the Coulson firm a power of attorney with regard to federal income tax matters was presented to the Board of Directors?

* * *

(Testimony of Alexander Perry Osborn.)

Q. (By Mr. Clark): If it was presented to the Board of Directors, with respect to which I will direct the witness' attention to page 2928 of Mr. Curry's deposition wherein appears, read into the record, a portion of the minutes of the meeting of the Board of Directors of the corporation held on June 17, 1938 (handing to witness): If you will start right there at the bottom of the page (indicating)?

The Court: Well, what is your question, as to whether or not he recalls this meeting?

Mr. Clark: Yes, indeed, your Honor.

A. Well, I don't know whether I was present at that meeting or not.

The Court: Have you any recollection on that?

The Witness: I have no recollection of it.

Q. (By Mr. Clark): Have you any recollection of having been on any occasion the matter of Polk's receiving a power of attorney from the plaintiff corporation presented to the plaintiff's Board of Directors? A. Well, I remembered——

Mr. MacKinnon: I object to it on the grounds it is irrelevant and incompetent to any matter in issue, as to the period in question.

The Court: The witness has already said that he has no recollection.

Mr. Clark: The witness has no recollection.

Q. Now, Mr. Osborn, I show you a copy of the letter which has been called in this case the "second Krigbaum letter" dated May 19, 1947, and which

(Testimony of Alexander Perry Osborn.)

is in evidence as Plaintiff's trial exhibit 71 (handing to witness), and after you have examined that, I will ask you whether or not that letter was taken up with the Board of Directors of the plaintiff corporation by Mr. Polk prior to the time it was sent; namely, May 19, 1947.

A. No, it was not.

Q. And when was the first time, Mr. Osborn, that you learned that such a letter had been sent? That is, the letter which is Plaintiff's trial exhibit 71?

A. I first heard of the letter at the time of the actual settlement, which took place in August, 1947.

Mr. Clark: That is all, your Honor.

The Court: Anything else on redirect?

Mr. MacKinnon: I didn't hear the answer, your Honor.

The Court: Would you read the answer?

(Previous answer read by the reporter.)

The Court: Any redirect?

Mr. Adams: Just one or two questions, your Honor.

Redirect Examination

By Mr. Adams:

Q. During the period while these consolidated returns were being filed, Mr. Osborn—that is the returns for '43, '43, and '44—did you know that the firm of Whitman, Ransom, Coulson and Goetz had been engaged to advise as tax counsel in respect of these returns? A. Yes, I did.

Q. And did you ever make any inquiry from

them with regard to the returns prior to the time when you learned of the stockholders' suit?

A. No, sir. [822]

* * *

FRANK C. NICODEMUS, JR.

called as a witness on behalf of the defendant, sworn.

The Clerk: Will you state your name to the Court, please?

A. Frank C. Nicodemus, Jr.

Direct Examination

By Mr. Adams:

Q. Mr. Nicodemus, do you have you residence in the State of New York?

A. State of New York.

Q. And your profession is that of an attorney, having your office——

A. In the City of New York.

Q. In the City of New York. Just what is the address of your office? A. 44 Wall Street.

Q. You were admitted to practice in Maryland in 1901? A. 1901.

Q. Of what bars are you a member?

A. Maryland Bar, New York Bar, and various Federal Courts, including, I think, this court.

Q. When did you first become associated with the firm of Pierce & Greer?

A. Definitely along about 1905. Prior to that time I had an association dating back to 1903.

(Testimony of Frank C. Nicodemus, Jr.)

Q. And when did you become a partner in the firm? A. 1920. [823]

Q. And you are now the senior partner in the firm? A. I am now the senior partner.

Q. Have you and the firm specialized in railroad practice? A. We have.

Q. Would you please state briefly some of the railroads that have been your clients?

A. When I came into the office, my then later senior partner, Mr. Wendell S. Pierce, was general counsel of the Union Pacific Railroad Company. The junior partner, Morris Greer, was assistant general counsel of the Union Pacific. The firm also held counselships for certain of various Gould roads including the Missouri Pacific, the Denver & Rio Grande, and I believe the Western Pacific. There were others, but I have named the principal ones, except perhaps I should mention the Wabash, which ultimately became my most important client.

Q. And you are now general counsel for the Wabash? A. I am senior counsel.

Q. Senior counsel. Were you well acquainted with Mr. Thomas M. Schumacher, who was one of the trustees in reorganization? A. I was.

Q. And you first become acquainted with him when?

A. I think in 1929 or '30. I first met him at the time he became a director of the Denver & Rio Grande Western Railroad Company, which was shortly after the James interests acquired their

(Testimony of Frank C. Nicodemus, Jr.)

stock position in the Western Pacific Railroad Corporation. [824]

Q. That was in 1926, was it not, to be sure about our times—if they are important?

A. I thought it was '27, but——

Q. About that time?

A. About that date.

Q. Now beginning some time in 1934, was your firm engaged as general counsel for the Western Pacific Railroad Corporation?

A. We were.

Q. And from that time forward, and so long as Mr. Schumacher was active in railroad business, did he look to you for day to day advice?

A. I think he did. In railroad matters.

Q. And did he, to your knowledge, ever consult any other counsel in respect of such matters?

A. Railroad matters?

Q. Yes.

A. I can recall no occasion when he did.

Q. Was it at his suggestion that you became general counsel to the corporation?

A. I think that it was.

Q. Now at the same time—that is, in 1934—Mr. Nicodemus, did your firm receive an appointment as general counsel to the Western Pacific Railroad Company, the subsidiary of the Western Pacific Railroad Corporation? A. Concurrently.

* * *

Q. (By Mr. Adams): Now, Mr. Nicodemus,

(Testimony of Frank C. Nicodemus, Jr.)

ever since 1934, have you made it a practice to attend the meetings of the board of directors of the plaintiff corporation?

A. Very regularly.

Q. Have you ever represented the Western Pacific Railroad Company in any matter in which its interest was opposed to that of the plaintiff corporation?

Mr. Phleger: Well, now, I think that is an improper question.

Mr. Clark: We will object to it on the ground it is——

Mr. Phleger: The attorney has just proved that he is attorney for both companies. I think it is irrelevant, incompetent and immaterial. [827]

Mr. Clark: And also it calls for the conclusion of this witness on a matter of law. Both these companies are now in this courtroom.

The Court: You want to know if at any time, while he was attorney for both of them, that he took a position—you don't expect him to answer that, do you?

Mr. Adams: Well, your Honor, he knows the answer to the question; I am just asking the question. I don't want to argue about it. If your Honor wants to make a ruling on it, I will proceed with the next one. Shall I ask another question, your Honor?

The Court: Well, if you think that it is of any great importance to ask the question, ask it. We know what his answer is going to be, but——

(Testimony of Frank C. Nicodemus, Jr.)

Mr. Adams: I am, of course, making a record. It is conceivable that the answer may be another way.

The Court: I will overrule the objection.

The Witness: I would like to have the question read.

Mr. Adams: Would you read the question, please.

(Question read.)

Mr. Clark: Well, may it please your Honor, may the time be specified and limited so far as the objection goes, to the date March 15, 1943, or at last October 11, 1943, when the District Court confirmed the plan which divorced these two companies? [828]

The Court: Well, you may have lurking in the question an opinion of the witness as to the precise transaction before the Court, if you asked it too generally.

Mr. Adams: Well, I will accept the limitation put upon it by Mr. Clark and ask that the witness answer that question.

Mr. Clark: Well, let us have the question, please. I don't know what the witness understood from my objection.

Mr. Adams: I will state it.

Q. Have you ever represented the company since March 15, 1943, in any matter in which its interest was opposed to that of the plaintiff corporation?

Mr. Clark: Object to that, your Honor, upon the ground it calls for the conclusion of the wit-

(Testimony of Frank C. Nicodemus, Jr.)

ness with respect to an representations during the so-called critical time in this case.

Mr. Phleger: Also it includes this lawsuit.

Mr. Clark: Right.

The Court: It calls for his opinion. You can ask him what he did.

Mr. Adams: I asked him if he represented the company.

The Court: Well, you would have to ask him what the representation was. When you asked him if he ever represented the company in any matter where there was conflict, if the matter in conflict is one of the issues before the Court, that is an answer to that, I think, without asking what he did or what [829] were the matters. I will sustain the objection.

Q. (By Mr. Adams): Now, were you the chairman of a special tax committee of reorganized railroads that was organized in 1943 or 1944?

A. I was.

Q. And what was the general purpose of that committee?

A. Well, the general purpose of that committee was to secure by the passage by Congress of a bill that would give preferred stock that, prior to a reorganization or readjustment, had represented debt, the right to deduct dividends; just as theretofore the interest could have been deducted in income tax returns. There was a similar law in effect at that time limited to utilities.

(Testimony of Frank C. Nicodemus, Jr.)

Q. Were you thereafter a member of a second tax committee of the railroads, of which Mr. Atkinson was chairman? A. I was.

Q. And that committee operated during the years 1944 to 1947, or thereabouts?

A. I think it was organized, to the best of my recollection, about October, 1943.

Q. I see. And——

A. And ran on until the legislation was secured from the 80th Congress.

Q. And that was tax legislation relating to the tax positions of certain of the reorganized railroads? [830]

A. That was the legislation that gave a reorganized company that was reorganized under a new charter the same status under the tax law that was enjoyed by corporations such as the Western Pacific Railroad Company, which were able to preserve their charters throughout the reorganizing process.

Q. And do I understand you correctly, Mr. Nicodemus, that the legislation, the need for it, arose because of the decision of the United States Supreme Court in Helvering v. New Colonial Ice Company? A. That is correct.

Q. And that decision had to do with whether or not a deduction was a transferable thing?

A. No, the New Colonial Ice Company v. Helvering decision was in substance that the reorganized company was a different taxpayer from the

(Testimony of Frank C. Nicodemus, Jr.)

predecessor company, and that these carry-overs and carry-backs only applied to the same taxpayer.

Q. So that it couldn't take the carry-over or carry-back deduction? A. That is correct.

Q. Now, after the railroad company went into reorganization in August, 1935, you continued, did you not, with your general representation of the plaintiff corporation? A. I did.

Q. And you have continued as such up to this date? A. I have. [831]

Q. Did you from time to time give Mr. Schumacher advice as to the problems of the court's trustees in the reorganization?

A. I did from time to time.

Q. And it was the fact, was it not, that your firm was in receipt of a monthly salary from the railroad company while the trustees were operating it? A. That is correct.

Q. That was a continuation of the compensation arrangement pre-reorganization?

A. Yes.

Q. And that was authorized specifically in an early order made in the Bankruptcy Court, according to your recollection; that is true, is it not?

A. My recollection is this: That that was provided for in Order No. 1, signed by Judge St. Sure.

Q. Now, you also became, did you not, at that time the attorney to the debtor in reorganization?

A. I did.

(Testimony of Frank C. Nicodemus, Jr.)

Q. And in speaking of the debtor in reorganization, you have reference to the Western Pacific Railroad Company as the company that filed a petition in reorganization in August, 1935?

A. I was already the counsel for the Western Pacific Railroad Company, and I, with your former partner, Mr. Olney, filed the petition on behalf of that corporation for reorganization under Section 77. Then I continued to be the counsel for the debtor [832] throughout the reorganization proceeding.

Q. Mr. Olney and you jointly signed the petition that was filed for reorganization under Section 77 as counsel to the debtor company?

A. We did.

Q. Yes. And then shortly thereafter, when Mr. Olney was appointed as the attorney to the trustees, he withdrew as counsel to the debtor from that time forward; that is correct, isn't it?

A. Well, at the time of filing of the petition there was no requirement for the appointment of trustees under the Bankruptcy Law, and Judge St. Sure, although it was optional with the court, decided that to appoint a trustee was unnecessary, and that the business would go forward in a corporate form as it had theretofore.

The Court: The debtor remained in possession for a year?

The Witness: No, not as much as that.

The Court: Oh, not that much?

Mr. Adams: The statute was enacted very

(Testimony of Frank C. Nicodemus, Jr.)

shortly thereafter, requiring the appointment of trustees.

The Witness: I think about three months.

Q. (By Mr. Adams): My point is this, and this is the fact, is it not, Mr. Nicodemus: That at the time the trustees were appointed, in November, 1935, and the court authorized the appointment of Mr. Olney as their attorney, he then withdrew [833] as your associate as counsel to the debtor?

A. That is correct.

Q. And from that time forward you alone were the counsel to the debtor in reorganization?

A. That is correct; except that Mr. C. V. Dooling, who was an attorney in the San Francisco office of the Western Pacific Railroad Company, acted as co-counsel for the purpose of signing papers.

Q. Well, Mr. Dooling was an attorney in the law department of the railroad company, is that not the fact? A. That is correct.

Q. And he was like other employees of the railroad company, receiving a salary from the railroad company? A. That is correct.

Q. And his salary was paid by the court trustees after theey took over the operation of the railroad? A. That is correct.

Q. The same as your firm salary was paid?

A. That is also correct.

Q. But his name was not on the papers, was it?

A. Not on the original papers.

Q. Nor at any time as counsel for the debtor?

(Testimony of Frank C. Nicodemus, Jr.)

A. Oh, I think so. I think all papers that were filed on behalf of the debtor were filed with his signature, and his address as a local counsel in San Francisco. [834]

Q. To the debtor? A. Yes.

Q. I see. Now, in 1939 the Commission, of course, promulgated its modified plan of reorganization. You recall that?

A. The promulgated plan came out about that time, which was afterwards slightly modified.

Q. Then it was taken to the court here under the procedures prescribed, and it came to the court then?

A. It came to the court automatically under the Bankruptcy Act.

Q. Yes. And thereafter Judge Sloss was designated by the corporation to be the corporation's attorney in the proceedings in reorganization in the court?

A. He was authorized, I think, to intervene in the proceedings and to represent it.

Q. You, however, continued throughout your general representation as general counsel for the plaintiff corporation?

A. In cooperation with Judge Sloss.

Q. And you say "in cooperation with Judge Sloss." Do you mean in respect to the matters in reorganization, you cooperated with him?

A. That is right, that is correct.

Q. And you continued throughout also to act in the capacity of attorney to the debtor?

(Testimony of Frank C. Nicodemus, Jr.)

A. Up through the decision of the Supreme Court. [835]

Q. And continuing throughout the reorganization?

A. And continuing throughout the reorganization proceeding, up to December 31, 1944.

Q. Now, did Mr. Schumacher ever suggest to you that the interests of the corporation in the reorganization should not be fully protected?

A. He did not.

Q. Did you, to the best of your ability, protect the interests of the corporation in reorganization?

The Court: Well, what is the materiality of this phase of the case? There is no point being made, is there, that generally there was any adversity between the interests of the corporation and the debtor during reorganization?

Mr. Adams: There is a contention, your Honor, that the James interests dominated and controlled the plaintiff corporation, its agents and representatives.

The Court: Only with respect to this particular matter.

Mr. Adams: Well, not as I understand it; I understand the interveners' position to be that they propose to show that the James interests dominated and controlled the plaintiff corporation.

The Court: Well, they have presented the facts, the various positions occupied by the various persons, to show that in effect there was a control.

(Testimony of Frank C. Nicodemus, Jr.)

But there is no claim made that there was any dominance in any respect, except that the facts with respect to what was done in the tax transactions—as to what they show.

Mr. Clark: Now, how this transactions was accomplished, your Honor—that is all we attempted to show.

Mr. Adams: Now, just one moment.

The Court: I don't see any point in going back over all the years and finding out what Mr. Schumacher said to everybody connected with the company as to what their duties were as between the corporation and the defendant—unless you feel that some background material is necessary to your case.

Mr. Adams: Well, your Honor, the contention is advanced here and expressed by interveners that the James interests dominated and controlled the plaintiff corporation. It is perhaps that the James interests dominated and controlled the particular transaction only; that, to me, is almost incomprehensible. The question would be domination and control—did it exist or didn't it? The arguments made that the James interests, up until March, 1943, had their financial stake on the corporation's side and after that had their stake on the reorganized company's side—and I have heard those arguments, your Honor——

The Court: Maybe I hadn't thoroughly grasped it, but I didn't think that that word was used in any sinister light, but that it was merely the fact

(Testimony of Frank C. Nicodemus, Jr.)

of ownership that brought about a situation whereby they could have, had there arisen any [837] necessity, secured the accomplishment of such matters as they wished. From a legal point of view, not from any point of view that there was any actual dominance for any improper purpose.

Mr. Adams: But dominance, your Honor, is quite a different thing from the possession of a substantial or even a controlling stock interest. Domination is a fact, whether or not the James interests did dominate these officers and directors.

The Court: But not with respect—not generally speaking.

Mr. Clark: We didn't care about——

The Court: Nobody has raised any such question as that, as I understand it.

Mr. Adams: Well, I don't understand how it can be that you dominate directors of a corporation if you are a stockholder. How could it be that you dominate parties, limiting your dominance to a particular transaction? Isn't it material to show that the directors were independent people, always independent people in all respects?

The Court: That is no more than what we have discussed many times before, that we show a man has always been a good man, so now why should you charge him with doing something wrong at a particular time. Not that that is a particularly happy illustration, but I don't get any contention here in this case made by anybody on behalf of

(Testimony of Frank C. Nicodemus, Jr.)

the plaintiff or the interveners that there was any general domination of anyone [838] in the affairs of these companies, except in connection with this tax matter.

Mr. MacKinnon: Let them put that on the record. Let the interveners put that on the record and get it nailed to one spot for all time.

Mr. Clark: That is the answer to it, your Honor; I put it on the record as many times as we have discussed this particular problem, and no later than last evening, I called attention to the limitation with respect to the allegations of domination in the complaint in intervention which we submitted to your Honor at the pre-trial. Now, the allegations are now, so far as the pleadings are concerned and irrespective of proof, that we contend that in these tax matters the James interests, through Coulson, dominated the plaintiff corporation to advantage the railroad company, of which Coulson was an agent. That is the allegation. Now, the proof adduced in support of that, your Honor, applies only to this transaction and it is the same thing which Mr. Phleger describes as the "taking over by the railroad company." The idea of venality doesn't enter into it at all. The facts are as shown on the prima facie case, that in a situation where Mr. Coulson, who was the tax counsel for the railroad company as well as the corporation, representing both of them, it being to the advantage of another of his clients whom he

(Testimony of Frank C. Nicodemus, Jr.)

represented, the James interests, whose stake was in the railroad company, to [839] advantage the railroad company, does what? His partner, Polk goes not to the directors here, but to Mr. Curry.

The Court: Well, I just don't recall any testimony that has been offered in this case that indicates in any way, or from which any inference could be drawn, that there was any dominance exercised in any way at any time, except in connection with the tax matters.

Mr. Phleger: That is our position and that is all the proof shows.

Mr. MacKinnon: I understand now the record is clear that if the interveners have taken a contrary position, that they are now on record that that is all they are charging.

The Court: Well, irrespective of what, they contend, that is all the evidence that is here shows. There is no evidence that at any time any director of the corporation was ever asked to do anything or perform any function in accordance with the directions of the James interests or anyone else who controlled the railroad company at any time, except in connection with these tax matters. I don't know of any such evidence otherwise. I notice that Mr. Adams very meticulously this morning, in connection with the testimony of Mr. Osborn, went over all these matters to point out that at no time was he asked to do anything by anyone. But no one made any claim that anybody was asked to do anything of that nature at any time during

(Testimony of Frank C. Nicodemus, Jr.)

the time during the time that such a person was acting as a director [840] of one or both of these companies. I don't recall any such evidence.

I don't want to be in a position of cutting off anything that you think is necessary to the defense, but I just don't see that there is anything involved in that.

Mr. MacKinnon: Well, that is all we are interested in, getting the record clearly shaped as to what we have to meet.

The Court: If there is any doubt about it, why, I merely asked this question as to whether or not there is any need for this kind of testimony.

Mr. MacKinnon: I understand your Honor's position, but this is the first time I have heard the interveners take the clear-cut position on the record, and I tried to force them yesterday to do it.

Mr. Clark: Why, we have, from the pre-trial, your Honor. The evidence speaks for itself, and the allegations are very clear in the case. [841]

* * *

Q. (By Mr. Adams): Mr. Nicodemus, when did you first meet Mr. A. C. James?

A. I knew Mr. James slightly for many, many years, but I first got to know him in 1934.

Q. When did you first meet Col. Coulson?

A. 1932.

Q. Were either you or your firm, Pierce & Greer, ever retained to do any legal work for A. C. James individually or any of the James companies or James Foundation of New York?

(Testimony of Frank C. Nicodemus, Jr.)

A. Never.

Q. Were you or your firm ever retained to do any legal work for the firm of Whitman, Ransom, Coulson and Goetz or for Col. Coulson?

A. Never.

Q. As counsel for the plaintiff did you ever receive any directions or instructions from Mr. James? A. Never.

Q. Or from any representative of the James interest? A. Never.

Q. Did you take the directions or instructions of anyone as to what legal advice you should or should not give to the plaintiff corporation?

A. Never.

Q. Were you dominated or controlled in any way in any of your activites as counsel for the plaintiff or as counsel for the [842] debtor?

A. No.

Q. At the beginning of 1943, Mr. Nicodemus, you knew, did you not, the difference between consolidated and separate returns?

A. I did vaguely.

Q. What do you mean when you say "vaguely"?

A. I mean that I was not familiar with the tax law as a tax expert.

Q. What did you understand was the difference between consolidated and separate returns?

A. In consolidated returns the return was filed by the parent, which must be a 95% owner of the subsidiaries that constituted the affiliated group. I think I was aware of that.

(Testimony of Frank C. Nicodemus, Jr.)

Q. You were aware, were you not, in a consolidated return the income, the debits and credits of the members of the group were taken into the return?

A. In a general way I was.

Q. So that losses of one company would offset gains of another in the computation of the tax liability? A. Correct.

Q. You understood that, did you not?

A. I understood that.

Q. You understood also the separate returns were the separate returns of the individual concerns? A. I thought I understood that. [843]

Q. Taking into account only their own incomes, debits and so on. It is a fact, is it not, that your employment as counsel for the railroad company terminated as at the end of 1944?

A. December 31, 1944, except as to minor matters.

Q. You did continue to handle a few minor matters which were then in your hands?

A. A few minor matters which were in my hands and one or two still pending, I think.

Mr. Clark: Just one moment, your Honor. I think the evidence shows the employment was by the reorganization trustees, among others, up until December 31, 1944.

Mr. Phleger: The evidence also shows, and the receipted bill is in the record, that the defendant company paid the witness' firm for legal services rendered throughout 1945.

(Testimony of Frank C. Nicodemus, Jr.)

Mr. Clark: As well, yes.

Mr. Phleger: That is in the record, a receipted bill.

Q. (By Mr. Adams): Mr. Nicodemus, the fact is, is it not, that you received a letter from Mr. Elsey, the president of the reorganized company to be, late in December, 1944, which informed you that the reorganized company did not expect to continue with the services of the firm of Pierce & Greer?

A. My answer is my relationship as corporate counsel was terminated as of December 31, 1944, with the reservation that we would continue to handle certain matters that were pending.

Q. That were then pending with you, and you did continue to [844] handle such matters?

A. We have.

Q. And it was as to such matters that you sent special bills to the railroad company which were paid? A. That is correct.

Q. Aside from that you never had any legal representation of the reorganized company?

A. No.

Q. And I take it you have not had any other official office or professional relation to the reorganized company? A. No.

Q. In behalf of the plaintiff corporation you have had in charge, have you not, certain claims against the Railroad Credit Corporation that arose out of the reorganization? A. I have had.

(Testimony of Frank C. Nicodemus, Jr.)

Q. And did your work in the matter begin early in 1944?

A. I think it did. I think it began in November, 1944.

Q. And you have carried that through since to a successful conclusion?

A. Yes, we did, in Maryland courts.

Q. Will you state briefly the nature of that claim.

A. The Western Pacific Railroad Company had borrowed from the Railroad Credit Corporation certain monies aggregated 7,000,000 and it gave as collateral certain securities belonging to it. In addition, the Railroad Credit Corporation demanded that the [845] Western Pacific Railroad Corporation, the parent company, contribute additional collateral to that loan, which is sometimes referred to, and is referred to in the decision of the Supreme Court as accommodation collateral. In the case of the Railroad Credit Corporation that accommodation collateral consisted of advances made by the Western Pacific Railroad Company to a solvent subsidiary of the railroad company, that amounted to $110,000, I believe, and our conception was the the Railroad Credit Corporation has been made whole out of the collateral provided by the principal debtor, and the accommodation collateral is thereby released, and we prevailed in that contention.

(Testimony of Frank C. Nicodemus, Jr.)

Q. That solvent subsidiary was the Standard Realty and Development Company?

A. Standard Realty and Investment Company.

Q. You have also had in your charge, have you not, a claim by the parent corporation against the Reconstruction Finance Corporation arising out of the reorganization?

Mr. Phleger: May it please the Court, I think this is all utterly immaterial, incompetent and irrelevant. I do not want to be interrupting interposing objections, but it is utterly immaterial. [846]

* * *

The Court: This litigation that you are now questioning the witness about, this employment, took place when?

Q. (By Mr. Adams): The R. F. C. claim—you started investigating that when, Mr. Nicodemus?

A. It was part of my continuous employment as counsel for the Western Pacific Railroad Corporation.

The Court: I mean, when were the activities that Mr. Adam referred to? When did they take place?

A. They started those activities in November, 1944, just before the end of the reorganization.

The Court: And that was litigation in which

(Testimony of Frank C. Nicodemus, Jr.)

the corporation was involved?

Mr. Adams: Yes, your Honor.

Mr. Phleger: And the defendant was not involved. [852]

The Court: And the defendant was not involved?

Mr. Adams: That is correct.

Mr. Clark: Nor any of the substance of this litigation.

The Court: Is there much of this kind of testimony?

Mr. Adams: No, your Honor.

The Court: I will overrule the objection.

(The last question was read by the reporter as follows: "Q. You have also had in your charge, have you not, a claim by the parent corporation against the Reconstruction Finance Corporation arising out of the reorganization?") [853]

A. We have.

Q. And are you proceeding now with that claim, Mr. Nicodemus? A. We are.

Q. Now, you have also had, have you not, with Mr. Osborn, a claim arising out of the reorganization in behalf of the plaintiff corporation, against the Sacramento Northern Railway and against the reorganized railroad company?

A. I would not characterize that as a suit arising out of the reorganization.

(Testimony of Frank C. Nicodemus, Jr.)

Q. Will you please tell the Court what it was.

A. It was a suit on an open account between the Western Pacific Railroad Corporation, the plaintiff in this case, and the Sacramento Northern Railway, a subsidiary of the Western Pacific Railroad Company.

Q. And did you——

Mr. Clark: May we have this particular matter fixed as to time, your Honor?

The Court: Yes.

Q. (By Mr. Adams): You began work on that, did you not, in the middle of 1945?

A. I think so.

Q. And that is litigation in which you, in behalf of the plaintiff corporation, are a participant as its counsel, and in which the reorganized railroad company is an adverse party?

A. That is a correct statement. [854]

Q. And are you still pressing this claim in behalf of the plaintiff corporation? A. We are.

Q. Now, Mr. Nicodemus, have you felt free at all times to assert against the reorganization trustees or against the reorganized company any claim in behalf of the corporation which occurred to you?

A. That is certainly true as against the reorganized company; whether I was ever prepared to present a claim against the trustees in another matter. I was counsel for Mr. Schumacher in his capacity as trustee—I don't think I would have sued him.

(Testimony of Frank C. Nicodemus, Jr.)

Q. Well, you bear in mind, do you not, that the presentation of a claim during the bankruptcy would not have been a suit against the trustees? You had that in mind, didn't you?

Mr. Clark: We object to that on the ground it is a conclusion, and argumentative.

Mr. Adams: I will submit it.

The Court: Well, that would have been an adverse interest, wouldn't it? The man couldn't act as attorney for the corporation and—that is, the reorganized corporation—he couldn't act as attorney of the railroad company, the holding company, the holding company here and also for the trustees in a dispute between them, could he?

Mr. Adams: Oh, but, your Honor, I think that is exactly [855] what he could do, because the trustees were the court's agents and any claim would have been a claim presented to the court.

The Court: I would never let a lawyer appointed in my court in a bankruptcy matter pursue that sort of thing. It is true that the trustees are officers of the court, but they are charged with preserving the res for the benefit of all parties involved, and if somebody asserts some claims that would involve, or have its impact, upon that res, certainly the man that asserts the claim couldn't be represented by the same man who represents the trustee as an officer of the court.

Q. (By Mr. Adams): Well, now, of course, it is a fact, is it not, Mr. Nicodemus, that you never

(Testimony of Frank C. Nicodemus, Jr.)

were an officer of the court as an attorney to the trustees?

Mr. Clark: Well, just a moment. That again calls for a conclusion. The evidence, may it please your Honor——

Mr. Adams: May we have this as an objection, your Honor?

The Court: Yes.

Mr. Clark: Very well, it calls for the conclusion of the witness.

The Court: Ask the question, Mr. Adams, and then I will rule.

Mr. Adams: Yes, your Honor. Would you read the question, please.

(Question read.)

The Court: Well, I think what you want to find out is, [856] was he an attorney for any of the trustees. Is that what you want?

Mr. Adams: Your Honor, what I have in mind to establish is that the attorney to the trustees was another gentleman. He was the lawyer appointed by the court for that purpose.

The Court: Who was that?

Mr. Adams: Formerly Mr. Olney and subsequently Mr. Matthew, occupying those positions.

Q. Now, it is a fact, is it not, Mr. Nicodemus, that you never occupied an official position as attorney to the trustee?

A. I was never the statutory counsel for the

(Testimony of Frank C. Nicodemus, Jr.)

trustee under Section 77 of the Bankruptcy Act.

Q. But it is further the fact that you from time to time, in an informal way, gave advice to Mr. Schumacher about his trustee affairs in New York?

A. Correct.

Mr. Adams: Now, that is precisely the situation.

Mr. Phleger: Well, it was paid for by orders allowed by the Bankruptcy Court.

Mr. Adams: Now, if your Honor please, this is argument and interjection, and if we are going to have objections to my questions, it should be in an orderly form.

Mr. Phleger: He is not stating the evidence correctly, your Honor.

Mr. Adams: May I be heard without interruption for a [857] moment? I perceive that counsel, very appropriately, have in mind that their argument may be presented while I am asking the witness.

The Court: Yes, I think you are right about that. There is a little too much argument, and we are getting away from the evidence here.

Mr. Adams: I thing that there is no question before the Court at the moment.

The Court: I have forgotten now what gave rise to the original objection.

Mr. Adams: The question that your Honor suggested was whether or not the attorney to the trustee would be in a position to present a claim to the Bankruptcy Court against the trustees. Your Honor suggested the question itself.

(Testimony of Frank C. Nicodemus, Jr.)

The Court: Attorneys for the corporation.

Mr. Adams: Well, your Honor suggested, as I understand it,—the question in your mind was—as to whether the attorneys for the court's trustees would be in a position to present a claim in the Bankruptcy Court in behalf of the plaintiff corporation running against the trustees.

The Court: You seem to think that he wouldn't because he hadn't an official position as attorney.

Mr. Adams: And I point out through these questions and answers that he did not occupy that official position.

The Court: Well, nevertheless I don't think that he would [858] urge a claim against a trustee if he were unofficially or in any other way advising the trustee. How could he do that?

Mr. Adams: Well, this is a bankruptcy proceeding, your Honor, and this is a court in bankruptcy, and this gentleman is the general counsel for the plaintiff corporation, whose function it is to look after the corporation's affairs, and who brought into the Bankruptcy Court—take for example, that RCC matter.

Q. You appeared, did you not, Mr. Nicodemus, in the Bankruptcy Court in behalf of the plaintiff corporation, upon the hearing in the RCC matter?

A. I think I did.

The Court: That wasn't against the trustees, was it?

Mr. Adams: That was against the Railroad Credit Corporation.

(Testimony of Frank C. Nicodemus, Jr.)

The Court: Yes, it was against the RCC.

Mr. Adams: That is right, in the Bankruptcy Court.

The Court: But I don't see how the witness could be attorney for, and present a claim on behalf of, the Western Pacific Railroad Company, an adverse claim against the estate, the trust estate, and at the same time be an advisor to one of the trustees. I don't think there would be much argument about that. I don't know whether we are talking about some academic question or whether there is something of this sort involved here.

Mr. Adams: Well, it will develop, your Honor.

The Court: Let us go ahead, then.

Q. (By Mr. Adams): Now, Mr. Nicodemus, do you recall that on or about May 24, 1944, you had a conversation with Mr. Thomas Tarleau and with a Mr. Rapp?

A. I do; but research and examination of my diary and files has developed the fact that this particular conversation occurred November 29, 1924.

Q. You mean 1944? A. Yes, '44.

Q. November 29, 1944?

A. November 29, 1944.

Q. Now, you recall that at the time your deposition was taken you gave some testimony in regard to that conversation? A. I do.

Q. And at that time you fixed the time by relation to your diary and other events, as May 24, 1944? A. That is correct.

(Testimony of Frank C. Nicodemus, Jr.)

Q. Now, will you please state, then, what it is that has brought about a reconsideration in your mind as to the time of that occasion?

A. Why the diary entry—what date did you give, the first date?

Q. May 24, 1944.

A. Oh, that date, I did go down to Washington with Mr. Tarleau on that date, but not with Mr. Rapp, as I remember it. I found [860] out afterwards that I met Mr. Rapp in Washington, so that demonstrated that I was mistaken as to the time when that talk took place, and I was able to communicate with my secretary, my former secretary, who had left me and gone up to Providence, and he came in and went over the files and confirmed that it was November—I think it was November 29—instead of May 29.

Q. Of the year 1944?

A. The year 1944.

Q. Now, you recall when you gave your testimoney upon your deposition that you first fixed that time as sometime over a period of a year, but no later than the middle of 1944?

A. I think I did, yes.

Q. And you are clear now that you were mistaken in that regard?

A. I am clear I was mistaken in that date.

Q. And the reason you now fix this date particularly is that this is the only diary entry date that fits an occasion when you talked with these two gentlemen?

(Testimony of Frank C. Nicodemus, Jr.)

A. Oh, no, no. We went further than that. We got a record of the reservations made from New York to Washington and the occupants of the drawing room, and so forth, which establishes in my mind that that took place in November, and that was confirmed by my secretary, who was along with us. I don't think I mentioned that in prior testimony; I had forgotten that he had been there. [861]

Q. Well, now, then, is it your best recollection at this time that the discussion you had with Mr. Tarleau and Mr. Rapp took place November 29, 1944? A. That is correct.

Q. And who were Mr. Tarleau and Mr. Rapp?

A. Mr. Tarleau, Thomas Tarleau, was the legislative counsel to Secretary Morgenthau until a short time before this conference took place. He had retired from that office and become a partner in a New York law firm, of which the late Wendell Willkie was a senior partner. The name has changed a number of times, and I cannot remember it. He was also a member of this tax committee on reorganized railroads that was working on legislation such as I referred to this morning, that eventuated in the passage of a bill by the 80th Congress.

Q. Now, on the occasion that you and I are talking about, that is the time you went down to Washington on the train with these gentlemen?

A. Yes; Mr. Rapp I haven't told you about.

Q. Oh, please do.

A. Mr. Rapp was formerly the minority clerk

(Testimony of Frank C. Nicodemus, Jr.)

of the House Ways and Means Committee and became a member of the office staff of Simpson, Thatcher & Bartlett, a very eminent law firm in New York.

Q. At a later time?

A. No, at that time, at the time of this conference. [862]

Q. Well, I mean at the time of the conference was he with the law firm?

A. He was with the law firm. And that law firm was counsel for this committee.

Q. So that these two gentlemen, to put it shortly, were tax lawyers who were specialists in tax law?

A. Tax legislation, I think, and tax law, too.

Q. Yes. And you had a discussion with them on the train on the way down to Washington?

A. I did.

Q. And you were on your way down there in connection with work for the tax legislation committee of which you were a member?

A. That is correct.

Q. Now, was it on that occasion, during that trip, that you brought up and discussed with Mr. Tarleau and Mr. Rapp the question whether a loss concern in a consolidated return might have a claim on account of the tax benefits that its loss produced? A. It was.

Q. And you had never discussed that idea prior to that time with anyone, had you?

(Testimony of Frank C. Nicodemus, Jr.)

A. Not that I recall.

Q. You had never discussed it with your partner, Mr. Campbell? A. No.

Q. Or with Mr. Schumacher? [863]

A. No.

Q. Or with Mr. Coulson? A. No.

Q. Or Mr. Polk? A. No.

Q. And so far as you can recall, this was the first time on which you ever discussed the idea with anyone? A. That is correct.

Q. It had occurred to you some time previous to this discussion?

A. Well, it had occurred to me—how far previous, I cannot tell. It grew out of a letter that was written by Mr. Schumacher to Mr. Ehrman back in April, 1943. There was a mention in that letter of a tax saving inuring to the benefit of the Tidewater Southern, and apparently that made no particular impression on my mind at the time. But some time later, and I think quite close to the date at which this talk occurred with Messrs. Tarleau and Rapp, I reread that letter, and it seemed to me that it might have some application to the Western Pacific Railroad Corporation, because it had gone into these consolidated returns, and then had contributed its operating loss, which was a loss growing out of the interest accrued on collateral loans to the Chase Bank and Hanover Bank and Trust Company and the James Foundation. And I raised the question with them as to whether the fact that that

(Testimony of Frank C. Nicodemus, Jr.)

loss was contributed [854] didn't create an equity in favor of the contributing parent.

Q. You are now speaking of this discussion on the train going down with Mr. Tarleau and Mr. Rapp?

A. That is what I understood you to inquire about.

Q. Yes, that's right. Go right ahead. I would like to hear all you recall about that conversation.

A. Mr. Rapp spoke up promptly and said, "No," he didn't think that it would create an equity, that "whoever heard of a tax law that was equitable"; and in his judgment, that the loss would not create an equity. Mr. Tarleau was not as specific or as dogmatic as Mr. Rapp. He said he would probably agree with him. And that is the substance of that conversation.

Q. Well, now, did you express any view yourself with regard to the idea?

A. Well, I was not convinced by their doubts. It still remained in my mind that that might create an equity that would be cognizable in a court.

Q. Did you have any subsequent discussion of that subject with either Mr. Tarleau or Mr. Rapp; that is, prior to the time that the stockholders' suit was instituted in the middle of 1946?

A. No, not that I remember.

The story of that talk with Messrs. Rapp and Tarleau is incomplete unless I tell you that the next day we also had a conference with another lawyer in Washington. [865]

(Testimony of Frank C. Nicodemus, Jr.)

Q. Yes. Please proceed with that. You say "we." But did Mr. Tarleau and Mr. Rapp participate in the conversation you had with Mr. Dudley?

A. I think they were present.

Q. Oh, you do?

A. At least they were present—we were all together, and my best recollection is that Mr. Tarleau left and Mr. Rapp left, to go to their respective appointments. I discussed it further with Mr. Dudley. Mr. Dudley was a Washington lawyer who was on this tax committee, and he said it was a question he hadn't thought of but might have some merit. And I said, "Well, maybe some day it will become a practical question."

Now, that was the substance of my talk with Mr. Dudley.

Q. Now, at the time did you tell these gentlemen that you were discussing this from the point of view of the Western Pacific or any of its subsidiaries? A. I did not.

Q. You just approached the subject as an academic question?

A. As an academic question, yes, sir.

Q. Now, have you told me the substance of the conversation you had with those gentlemen at that time on that subject?

A. As well as I can remember it.

Q. Now, subsequent to that time, and until the stockholders' suit was commenced in the middle of 1946, did you have any further conversation with

(Testimony of Frank C. Nicodemus, Jr.)

anyone? [866] A. Not that I can recall.

Q. With regard to this question of the possibility of a claim by the loss company on acount of the benefits of its loss in a consolidated tax return?

A. What date did you put?

Q. Any time up to the time when, in the middle of 1946, the stockholders' litigation was started.

A. Not prior to the institution of the stockholders' suit.

Q. And now, subsequent to your discussion with Mr. Tarleau and Mr. Rapp and your discussion with Mr. Dudley, did you advise Mr. Schumacher in regard to that discussion?

A. No, I did not.

Q. Did you advise Mr. Coulson or Mr. Polk in regard to it? A. No, I did not.

Q. Or Mr. Curry? A. No.

Q. Or anyone else in the plaintiff corporation?

A. No.

Q. Or did you advise, in fact, anybody about it?

A. No.

Q. Did you talk with your partner, Mr. Campbell, about it? A. Not that I recall.

Q. Now, was that for the reason that it appeared to you at that time that these gentlemen had not indicated that there was such a claim? [867]

A. It didn't occur to me that it was a practical claim at that time.

Q. Now, if you had considered at that time—strike that.

(Testimony of Frank C. Nicodemus, Jr.)

You bear in mind, Mr. Nicodemus, that as at the end of 1944, the trustees' operation of the railroad company came to an end? A. That is correct.

Q. You bear in mind also that the reorganization court remained open for certain purposes until March 1946; you have that in mind, do you?

A. I think that is correct.

Q. Do you bear in mind also that your representation of the railroad company, your official representation of that company, came to an end at the end of 1944? A. That is correct.

Q. Now, was there anything to prevent you from presenting this possible claim of the corporation to the reorganization court if you had desired to do so?

Mr. Clark: Well, now, just a moment, may it please your Honor. I will object to that upon the ground that it is vague and indefinite and assumes something not in evidence or not sufficiently explained—namely, as to what loss is referred to in the question. There is a distinction, as counsel well knows, between the loss which was discussed in these conversations with the witness and the preent stock loss. [868]

Mr. Adams: I will submit it, your Honor.

Mr. Phleger: Well, I will object to it as calling for the conclusion of the witness.

The Court: Well, I think that objection is good.

Mr. Adams: This witness knows, your Honor; he is an adverse witness, I am cross-examining him.

(Testimony of Frank C. Nicodemus, Jr.)

The Court: You can, of course, have a field of inquiry there; you can ask him what he did do, what he did not do, with reference to the loss. But what his relationship was, his company—I think that the question you are asking him is one that calls for the opinion and conclusion on his part.

Mr. Adams: Well, I take it that the objection is sustained to the particular question?

The Court: I think I will sustain the particular objection. I believe you can approach the problem you have in mind in a different way.

Q. (By Mr. Adams): Now, Mr. Nicodemus, it is the fact, is it not, that between the time you had these discussion with Mr. Tarleau, Mr. Rapp and Mr. Dudley, and the time when the stockholders' action was instituted in New York in the middle of 1946, you did not take any further action of any sort in reference to the suggestions that you discussed at that meeting with those gentlemen?

A. No, the whole tax matter was in the hands of Whitman, Ransom, Coulson & Goetz; that was purely an academic discussion. [869]

Q. You took no action yourself of any sort in regard to that matter? A. No.

Q. And you didn't mention it to Whitman, Ransom, Coulson and Goetz or any of its members?

A. No, I did not.

Q. Nor to Mr. Schumacher? A. No.

Q. Nor to Mr. Curry? A. That is correct.

Q. Or Mr. Osborn? A. That is correct.

(Testimony of Frank C. Nicodemus, Jr.)

Q. Or Mr. Wood? A. That is correct.

Q. Nor anyone else? A. That is correct.

Q. Mr. Nicodemus, do you recall that you were asked some questions and gave some answers on this matter on the taking of your deposition?

A. Yes.

Q. May I ask that Mr. Nicodemus' deposition, page 255, be handed to him?

(Handed to the witness by the Clerk.)

Mr. Clark: What page is it, please?

Mr. Adams: 255. [870]

The Witness: I have it. Where do you want me to read?

Q. Beginning five lines from the bottom of page 255, referring to Mr. Dudley. This is a part of your answer (reading):

"Mr. Dudley said that he wouldn't say there was no equity, that he never considered the subject. It was new to him, but it was something worth thinking about."

Now is it your present recollection that that is what Mr. Dudley said to you at that time?

A. That is my recollection, and it is what I have just testified to in substance, isn't it?

Q. Thank you. Now, Mr. Nicodemus, in an answer to a previous question—you referred to a letter written by Mr. Schumacher to Mr. Ehrman, and I will ask that Interveners' Exhibit 30—I am sorry, your Honor. It will take a moment to produce this document.

(Testimony of Frank C. Nicodemus, Jr.)

Mr. Clark: If you have some of these ahead, may I suggest to the court that it might save time if we could have a few of them and be digging them out of the deposition file here?

Mr. Adams: I had best get along with my own cross-examination, and I can proceed better in this way. I don't think we will have this repeated. If it is satisfactory to counsel, I can proceed better this way. I can hand this to the witness—no, I had better not hand my photostat to the witness.

Q. Mr. Nicodemus, I hand to you a document now marked Interveners' Exhibit No. 30, being a copy of a letter dated April 1, [871] 1943, addressed by Mr. Schumacher to Mr. Ehrman, and I will read it to the witness and his Honor (reading):

"Dear Mr. Ehrman:

"Referring to our telephone conversation last evening, this morning I have looked up our records to see just what the expense of making up the consolidated tax returns in our office and the tax savings effected has been since the Western Pacific Railroad Company went into trusteeship.

"First of all, the certified public accountants, Lybrand, Ross Bros. and Montgomery, were employed by the corporation from year to year to audit the accounts pursuant to the provision of the Securities and Exchange Act. Their charge for this audit has averaged approximately a thousand dollars a year. For the past two years we have consulted them on excess profits tax on a consolidated

(Testimony of Frank C. Nicodemus, Jr.)

basis, and their charge for this was $150 in 1940 and $400 in 1941, which was paid by the corporation.

"This work has all been done in this office and consolidated tax returns have been prepared and filed under Mr. Curry's supervision.

"I might add that during the years the company has been in trusteeship, payment of income taxes for the consolidated group was nil, because of the large consolidated deficits. In fact, the Tidewater Southern, which made a [872] profit every year and was included in the returns, benefited by these deficits, which effected a tax saving to it of approximately $116,000 for the six-year period.

"During that period expert advice from counsel was not necessary. However, commencing with 1942, the situation was changed considerably because the affiliated companies' earnings have greatly increased. For that reason, and in view of the new complicated tax law, we now require the advice of competent tax attorneys.

"For your further information, I find that the last payment of consolidated income tax was made in 1929. At that time there was a net consolidated taxable income of $365,000 on which the income tax amounted to $40,230."

(Document handed to the witness by the Clerk.)

Q. (By Mr. Adams): Now, Mr. Nicodemus, is that the letter to which you referred in your testi-

(Testimony of Frank C. Nicodemus, Jr.)

mony about the conversations that you had with Mr. Tarleau, Mr. Rapp, and Mr. Dudley?

A. This is the letter.

Mr. Adams: The record shows, your Honor, that a copy of this letter from Mr. Schumacher to Mr. Ehrman went to Mr. Nicodemus.

Q. And the tax savings, according to your recollection, that [873] you had in mind in November, 1944, when you discussed that matter with those gentlemen, were those Tidewater Southern tax savings that are mentioned in this letter of April 1, 1943?

A. Well, tax savings that I had in mind at that time were the tax savings that grew out of the income accruals of the Western Pacific Railroad Corporation during that tax period.

Q. During what tax period?

A. The tax period in which this letter relates. This is a prior tax period. This is a historical reference to a prior tax year.

Q. Is it your recollection, then, that at the time you had this conversation with Messrs. Tarleau, Rapp and Dudley in November, 1944, that you only had in mind this letter written a year and a half before that date with regard to the Tidewater Southern? A. That is correct.

Q. I will ask that you turn to page 1091 of your deposition. A. I haven't got it.

Q. Oh, it is in another volume from the one you have before you. Do you have that before you now, Mr. Nicodemus? A. 1091?

(Testimony of Frank C. Nicodemus, Jr.)

Q. Yes. A. I do.

Q. May I read certain questions and answers?

A. Yes. [874]

"Q. Do you recall that you testified in your discussion with Messrs. Tarleau, Rapp and Dudley the tax savings that you had in mind was a tax saving arising out of the 1942 return?

"A. Yes, the operating loss.

"Q. That is to say, those were the tax savings?

"A. That is what I had in mind.

"Q. Those were the tax savings for that year to which Mr. Polk referred in his letter of May 20, 1943, were they not?

"A. Yes, they were, that is correct.

"Q. So that then you had in mind that portion of Mr. Polk's letter of May 20, 1943, in which he referred to the 1942 returns?

"A. That is correct.

"Q. Did you at that time have in mind that portion of the same letter in which he referred to the possibility of a loss being taken on account of the corporation's loss on the stock of the company?

"A. No, I did not.

"Q. Is it clear in your own mind at this time that you had in mind one specific part of that letter and did not have in mind another specific part of it?

"A. It is clear in my mind that I had in mind only savings that he specifically referred to in that letter and which were also referred to in the letter of April 1." [875]

(Testimony of Frank C. Nicodemus, Jr.)

Q. Now, you recall that I asked you these questions and you gave those answers at that time?

A. Probably I did, and I readopt them.

Q. Are they correct now, according to your best recollection?

A. According to my best recollection.

Q. Is it not a fact, Mr. Nicodemus, that the tax savings for the year 1942 that are mentioned in Mr. Polk's letter with relation to the returns for that year are stated in his letter in an amount somewhat in excess of a million five hundred thousand dollars? A. Yes, they are.

Mr. Adams: That is the letter of May 20, 1943, your Honor. Plaintiff's Exhibit 50 in the case.

The Witness: Only a very small part of that was applicable to this loss of the operating company—I mean the parent company.

Q. (By Mr. Adams): Well, is it a fact that at the time you had your discussion with Messrs. Tarleau, Rapp and Dudley you did at that time have in mind Mr. Polk's advice, his letter of May 20, 1943?

A. I think this correspondence back in the spring of 1943 was perhaps in my mind, but I do remember specifically that letter of April 1.

Q. Now, Mr. Nicodemus, at the time your deposition was taken you were asked when it was that you, according to your recollection, first heard about the use of the corporation's stock loss [876] in consolidated income tax returns filed with the parent corporation?

(Testimony of Frank C. Nicodemus, Jr.)

A. I believe I was asked about that.

Q. I will ask you the same question again. What is your best recollection as to the time when you first heard about that matter?

A. About the stock loss?

Q. About the use of the stock loss. Let me put it this way: You know now, of course, do you not, that the stock loss was a deduction in the consolidated return for 1943? A. I do.

Q. And that it operated there so that no taxable income was reported for that year?

A. I understand that.

Q. And you know now that the stock loss was a very large sum, something like $75,000,000?

A. I do.

Q. And that the taxes that have been accrued until they were reversed for the trustees amounted to something over $7,000,000? You know all those facts presently? A. Oh, yes.

Q. When was it, Mr. Nicodemus, according to your best recollection, that you first heard about those matters?

A. The first time I ever heard of the stock loss, to my best recollection, was in the last month of 1945, or the first or the [877] second months of 1946, when I was told so by Robert E. Coulson.

Q. Now, Mr. Nicodemus, I would like to review with you a number of things.

Your Honor, Mr. Nicodemus is aware of this because we did this on his deposition before, your

(Testimony of Frank C. Nicodemus, Jr.)

Honor, and it will take a little time because I have various documents and records to put before him, with two things only in view: one to show notice, regardless of knowledge, and the other to present to Mr. Nicodemus documents, some of which he did not see upon the taking of his deposition, that may possibly result in some recollection he does not now have, and I say that because I know it is going to take a little time and I will go right ahead with it.

Mr. Phleger: May I interrupt at this moment? I have not made an objection to this line of testimony. It is our view that the notice, knowledge, action, inaction of this witness can have no possible effect to destroy any claim which the plaintiff might have, and as a result this entire line of questioning is incompetent, irrelevant and immaterial. I would like to have our objection noted to this whole line. I have not made it before, but that is our conception of this case.

Mr. Clark: The intervener enters the same objection, your Honor.

Mr. Adams: I take it, your Honor, this must be cross-examination and I would submit that it is a material question, namely, according to his best recollection when did he hear [878] about these returns? Your Honor said everything was open and aboveboard in this transaction.

Mr. Clark: No, I think he testified when he first heard about the stock loss.

Mr. Phleger: I would like to bring this out:

(Testimony of Frank C. Nicodemus, Jr.)

This is no part of our case. We did not open the subject of notice or knowledge to Mr. Nicodemus. This is the defendant's affirmative case, and our position is it is utterly and absolutely immaterial what this witness knew or did not know, what he did or did not do.

Mr. Adams: Shall I proceed, your Honor? There is no question before you.

The Court: No, there isn't any question.

Mr. Phleger: There is an objection to this whole line of testimony.

The Court: You stated you wanted to show some documents to the witness that may cause him to make some change in his testimony as to when he did or did not have notice of the use of this stock loss as a part of the return. You say that is going to take a long time to do that?

Mr. Adams: It will take some time. There are a number of documents. I do not think it is going to take what might be termed an extensive time, and a day or anything like it.

The Court: Some of the trial judges seem to be getting—I guess we are all affected by it—getting overcautious in [879] permitting evidence to go in, in view of some of the decisions of the higher courts. I have been leaning that way in this case because obviously you have spent a lot of time and know so much more about this case than it is possible for a judge to learn about it in the short time of the trial. I do not see that when this witness

(Testimony of Frank C. Nicodemus, Jr.)
learned about any of these things has any relationship to the question that you are presenting here. I gather you have something more than what was stated in the opening arguments that is a very much more vital question which bears on this matter, and that any such matter as whether this witness learned about it six months ahead of time or what he learned about it I think is incompetent, irrelevant, and immaterial, Mr. Adams. What I am saying about the matter does not indicate that I am in favor of the plaintiff's side of the case at all, but you know your own case best now. If you think this is some vital matter that you have to pile up a big record on matters that really do not bear on the issues of the case, that is all right. There are a lot of big lawyers involved in this case. You have spent a lot of time studying it. You want to throw it all in before the judge. I do not see that it helps me to decide this case. I would much rather hear your arguments and all the arguments on the important and vital issues of this case than all this stuff about what conversations this witness had with some lawyer on a train going to Washington. That is not going to make any difference in my decision of the case. I am more [880] anxious to hear what your arguments are on the vital questions. If you think it is important to put all this stuff in the record, I will allow it.

Mr. Adams: Your Honor, I will state briefly why we think it is important. We think this evi-

(Testimony of Frank C. Nicodemus, Jr.)

dence goes to matters of defense and the effectiveness of the bar of reorganization for the reason that we apprehend that some contention may be addressed to your Honor that the gentlemen who could have spoken for the plaintiff corporation while Judge St. Sure's court was open for hearing claims, that those gentlemen were uninformed about this matter, and this testimony just given is testimony along that line. Now, we do not think we have to disprove what the witness says, but we do think we have to show he had adequate notice. He was one of the representatives of the corporation. We believe this is material and relevant to the defense we present of the bar of the reorganization proceeding. I am sure it has nothing to do with the merits of the claim on the side of the merits. I think it has a material bearing upon the defense of the bar.

Mr. Levy: I would like to say one word in connection with that. Your Honor will remember that we are dealing with split personality and Mr. Adams is seeking to impute to this man considerable knowledge. If your Honor will recall, if there was such knowledge it was equally imputable to his two other clients, namely, the trustees, under whom he had a retainer—call it a [881] salary if you wish, but it was a retainer for legal services—and secondly, the debtor company for whom he was the attorney, and thirdly, the reorganized company, for whom he acted as attorney during the year 1945. However

(Testimony of Frank C. Nicodemus, Jr.)

much Mr. Adams may seek to minimize the nature of services which were rendered, the fact does remain that this man was the attorney for whatever services he rendered for this reorganized company through the year 1945 and was paid for it.

Mr. Adams: I think that is quite immaterial. Your Honor, it is now a little past three o'clock. I will prepare to go right ahead with this. If your Honor considers I should make an offer of proof, I can do that. I do think it is a necessary part of my record and I am prepared to make the offer of proof or to take it up with the witness as your Honor may decide.

The Court: Let me ask you this question, Mr. Adams: How many witnesses do you have in mind at this time that you are going to call in this case? How long do you think the presentation of evidence will approximately take? [882]

* * *

Mr. Adams: Your Honor, at this time I will offer as Defendant's Exhibit 11 the document that I read into the record, being the letter from Mr. Schumacher to Mr. Ehrman of April 1, 1943.

Mr. Clark: Previously marked as what, Mr. Adams?

Mr. Adams: As Interveners' 30. [883]

(The document referred to was thereupon received in evidence and marked Defendant's Exhibit 11.)

(Testimony of Frank C. Nicodemus, Jr.)

Q. (By Mr. Adams): Mr. Nicodemus, there is in the record here an exhibit representing certain payments you received as compensation as attorney to the debtor. Is it the fact that all compensation you received as attorney to the debtor was allowed upon orders of the Interstate Commerce Commission and the bankruptcy court?

A. That is correct.

Q. Did you recommend to Mr. Schumacher that the Whitman, Ranson firm be employed as tax counsel for the reorganization trustees?

A. I did.

Q. And did you have in mind at that time the large earnings that were then being earned upon the railroad properties in the hands of the trustees?

A. I did.

Q. Do you recall that there was a conference in your office with Mr. Polk and others on May 18, 1943, with regard to income taxes for 1942?

A. I remember a series of conferences. I think one of them was May 18.

Q. Do you recall that that conference took place shortly after the returns for 1942 had been filed?

A. That is correct.

Q. Do you recall what took place at that conference? [884]

Mr. Phleger: Excuse me. You mean the tentative return?

Mr. Clark: No, the final return was filed on May 15, 1943.

(Testimony of Frank C. Nicodemus, Jr.)

The Witness: My recollection of what took place at that conference was that Mr. Polk explained to me, and which he had previously explained to me briefly, why he thought it was desirable to file consolidated returns, and there was some memorandum which he produced at that conference that was the subject of discussion, more with Miss Valouch and Mr. Curry than with me.

Q. Miss Valouch and Mr. Curry were also present at this conference?

A. They were also present, and I believe that Mr. Reilly was.

Q. At that conference was there a discussion about the possibility of using the stock loss in the following year's return?

A. All I think that was adverted to at that conference——

Q. Do you have a recollection of discussing that matter at that time?

A. It is pretty hard for me to say at this late date. There was a document shown to us in that conference that did refer to it.

Q. Is it your best recollection at this time that at that conference on May 18, 1943, you did hear that there was a possibility of using the stock loss in the following year's return?

A. I think there may have been some reference to it, but I did not charge my memory with the details of that conference. [885]

Q. Did you thereafter receive a copy of Mr.

(Testimony of Frank C. Nicodemus, Jr.)

Polk's letter of May 20, 1943, Plaintiff's Exhibit 50, if you please, Mr. Clerk?

A. In due course I received a copy of that letter from Mr. Curry.

Mr. Adams: The Clerk may hand the document to you.

Q. Now, did you read the letter, Plaintiff's Exhibit 50, at or about the time you received it, May 20 or 21, 1943?

A. Did I read the letter addressed to Mr. Curry?

Q. The letter of May 20, 1943, Plaintiff's Exhibit 50. There is also in the record a letter of May 21, 1943, addressed to you by Mr. Curry transmitting a copy of Plaintiff's Exhibit 50. Do you recall that you read that at or about its date?

A. I recall receiving that and I undoubtedly read it. How carefully I read it I am not able to say at this late date.

Q. Then did you thereafter discuss it with Mr. Schumacher, according to your best recollection?

A. I don't remember having discussed it with Mr. Schumacher.

Q. Now, you met with Mr. Schumacher very frequently, did you not, Mr. Nicodemus?

A. Very frequently.

Q. You were in his office almost as a matter of daily meetings during the time he was one of the trustees of the Western Pacific?

A. I was in his office very frequently.

Q. And did you discuss tax matters with him from time to time?

(Testimony of Frank C. Nicodemus, Jr.)

A. I never recall discussing tax matters with him. [886]

Q. You have no recollection of any such discussions? A. No.

Q. The record shows, Mr. Nicodemus, that early in January, 1944, the tax accruals of the railroad's properties are reversed, and you know about that now; we have mentioned it?

A. I know about that now.

Q. Did you receive regularly during that period the forms 174 revised issued by the Western Pacific Railroad Company, their monthly operating statements? A. Will you produce one?

Q. Yes, I hand to you 174 revised for December, 1943, marked Interveners' Exhibit 424A and ask that it be stipulated that this document was produced from the files of Mr. Nicodemus.

Mr. Clark: I am not sure of that. I think probably it was produced from the railroad company's files, Mr. Adams.

Mr. Adams: That is not my recollection. However, I do not think I will need the stipulation.

Q. It is a fact, is it not, Mr. Nicodemus, that you regularly received form 174 revised during that period?

A. I received from time to time financial statements sent to me by Mr. Curry, usually with my name on it in pencil. I do not remember whether it was green or blue. But such statements that came into my office currently and were filed for such future reference as might be necessary.

(Testimony of Frank C. Nicodemus, Jr.)

Mr. Adams: May I read, if your Honor please, from page [887] 1157 of Mr. Nicodemus' deposition?

Q. Do you have the deposition before you?

A. Some part of it. No, I have not.

Q. Page 1157, Mr. Nicodemus. A. 1157?

Q. Yes. Do you have the page? A. I do.

Q. Mr. Nicodemus, this question is by me, about ten lines from the top of the page.

A. I see it.

"Q. Referring to this file, Mr. Nicodemus, do you recall these printed forms on form 174A revised were received regularly by your office?

"A. They were produced from my files and I will adopt them as documents that were sent to me currently.

"Q. And you are familiar, are you not, with the fact that such monthly statements on form 174A revised were made by the Western Pacific Railroad Company? A. They were."

Q. Did you give those answers to those questions at that time?

A. I undoubtedly did and I readopt the documents as having been taken from my files.

Q. Referring to form 174A revised, which you have in your hand, for December, 1943, that form shows, does it not, the reversal of the tax accruals of the Western Pacific Railroad Company in [888] a very large sum?

A. Can you indicate the line it is on?

(Testimony of Frank C. Nicodemus, Jr.)

Q. "Railway tax accruals, federal income." You will find that just below the net revenue railway operations. Do you find that?

A. I see a heavy black figure.

Q. $6,759,886.13? A. Yes.

Q. You understand, do you not, that the black figures are minus figures?

A. I do not so understand. Ordinarily it is red, but if you say——

Q. Will you read the note, Mr. Nicodemus, at the bottom of this form 174A?

A. "Black face figures indicate entries in the reverse of the item as shown on the left hand column."

Q. Yes.

A. Apparently this is intended as the equivalent of a red figure.

Q. You were familiar with these forms, were you not?

A. I was when they were coming into my office currently.

Q. Do you recall whether at or about the time this form came in that it came to your attention?

A. I do not.

Q. Now then, the record shows, Mr. Nicodemus, that on or about February 21, 1944, a petition was filed in the reorganization [889] proceedings requesting authority to establish a reserve fund for contingent tax liabilities. I hand you a copy (handing document to witness).[889A]

(Testimony of Frank C. Nicodemus, Jr.)

Q. Now, as counsel for the debtor, Mr. Nicodemus, you received copies, did you not, of all petitions filed in the reorganization proceeding?

A. I did.

Q. And did you or Mr. Campbell make it a practice to read the petitions and orders that were filed in that proceeding?

A. They were referred to Mr. Campbell ordinarily, and he called my attention to anything that he thought was of special significance.

Q. Do you have any recollection of reading this particular petition? A. I do not.

Q. I hand you a copy of an order authorizing establishment of a reserve fund for contingent tax liability, made March 3, 1943, by the United States District Court. (Handed to witness through clerk). Your office received, did it not, all copies of orders as they were made from time to time in the bankruptcy proceeding? A. Yes.

Q. Do you recall seeing a copy of that order?

A. I do not; but I adopt it as an order which came to my office in the regular course of business.

Q. Do you recall looking at it at the time it came? A. No, I do not.

Q. Do you have any recollection of discussing with Mr. [890] Schumacher or Mr. Curry or anyone else, the reserve fund of $7,100,000 that had been set up?

A. I do not. I have no recollection of ever discussing that with Mr. Schumacher.

(Testimony of Frank C. Nicodemus, Jr.)

Q. Or with anyone else prior to the time that you spoke of, along at the end of 1945 or the beginning of '46? A. That's right.

Q. Is that right? A. That is correct.

Q. Now, you have read the 1943 annual report of the company, have you not, Plaintiff's Exhibit 20-B?

A. I received the annual reports in the regular course of business at the time they were issued.

Mr. Adams: May I ask that Plaintiff's Exhibit 20-B be exhibited to the witness, and I direct his attention to page 6. And at this time, your Honor, while the witness is looking at that page, may I offer as Defendant's Exhibit 12 the copy of the petition?

Mr. Phleger: That is already in evidence.

Mr. Adams: Is it? Will you give me the designation?

Mr. Phleger: I will find it here. We put it in.

(Plaintiff's Exhibit 20-B handed to witness by clerk.)

Mr. Adams: I am advised that the petition is in, not the order.

Mr. Phleger: Just a moment. I will give it to you. [891] Plaintiff's 58.

Mr. Adams: Is what?

Mr. Phleger: The petition to establish reserve fund for contingent tax liability, otherwise Interveners' 447-B.

(Testimony of Frank C. Nicodemus, Jr.)

Mr. Adams: I offer the order as Defendants' Exhibit 12.

(Order establishing fund referred to above was received in evidence and marked Defendants' Exhibit 12.)

Q. (By Mr. Adams): Now, Mr. Nicodemus, directing your attention to page 6 of the report of the Western Pacific Company, "T. M. Schumacher and Sidney M. Ehrman, Trustees in Reorganization, for the calendar year ended December 31, 1943," on page 6—— A. Page 6?

Q. Yes. Do you have it before you? I direct your attention to the statement there under the heading "Taxes," and I read a portion of it as follows:

"Owing to an unusual situation resulting from the recent final confirmation of the plan of reorganization, no accrual was set up in respect of Federal income and excess profits taxes for 1943. Since 1916, Federal tax returns of this company have been made through a consolidated return filed by the parent holding company, the Western Pacific Railroad Corporation, which parent owned all the capital stock of its subsidiary, the Western Pacific Railroad Company. [892]

"The confirmed plan of reorganization for the railroad company characterizes the capital stock stock owned by the holding company as being 'without equity or value.' A consolidated tax return

(Testimony of Frank C. Nicodemus, Jr.)

for 1943 can and will be filed by the holding company.

"Tax counsel has advised that the holding company's loss on its stock of the railroad company will result in an elimination of the liability of the holding company for Federal income taxes for the year 1943, and therefore indirectly eliminate such taxes for the subsidiaries of the holding company.

"However, pending a final settlement with the Treasury Department, the reorganization trustees, by authority of the court, have set aside a contingency reserve tax fund of $7,100,000, invested in United States Government Treasury savings notes—Series C."

And I direct your attention to what I have just read, and I will ask you if, at or about the time you received that report, you examined that statement.

A. I have no recollection of ever having read that statement. If I did read it, it left no impression on my mind. The reason perhaps being that tax matters had been referred to the firm of Whitman, Ransom, Coulson & Goetz, and were not my responsibility. [893]

Q. Would you say now that you are sure whether or not you saw that statement I have just read at or about the time that it was published?

A. I am sure that that made no impression on my memory. I have no recollection of having read it.

Q. You have no recollection one way or the

(Testimony of Frank C. Nicodemus, Jr.)

other, is that your statement? I am trying to find out the fact.

A. No, that is not my statement. I have no recollection of ever having read it.

Q. It is the fact, is it not, that you from time to time have referred to this annual report?

A. I am sure that from time to time I referred to all the reports for statistical information.

Q. Now, you recall that upon your deposition we inquired with regard to certain studies you made in Moody's Manual for 1943, do you not?

A. Yes.

Q. And you recall that at the time of your deposition, I produced for you the Moody's Manual for that year, which is the large volume?

A. That is correct.

Q. Manual of Steam Railroads?

A. That is correct.

Q. And that I directed your attention to the statement therein about the Western Pacific Railroad Company? [894] A. That is correct.

Q. And you recall that that statement set out the facts with regard to this tax matter in much the same form, substantially, as the one that this annual report you have just seen did?

A. I remember that.

Q. You recall that? A. I recall that.

Q. And is it now your recollection that though you did read Moody's Manual on the Western Pacific for other purposes, you have no recollection of reading that portion of it?

(Testimony of Frank C. Nicodemus, Jr.)

A. That was my recollection, and I should like to add that I examineed Moody's Manuals over a series of years for a specific purpose that had nothing to do with taxes.

Q. You examined Moody's Manuals, specifically in that connection—that is, the Western Pacific connection—in reference to this Sacramento Northern litigation? A. That is correct.

Q. That is right, is it not? A. Yes.

Q. Now, then, you received, did you not, the Eighth Annual Report and Account by the trustees of the property of the debtor and petition for approval of their acts and accounts? And I will read a section from page 2, as follows:——

Mr. Levy: What year is that?

Mr. Adams: The eighth report and accounting by the trustees was filed September 25, 1944, in the files in the [895] reorganization proceeding in this court, and there appears in that account, at page 3, beginning line 9:

"The net income as reported for 1943 did not reflect accruals for any Federal income or excess profits taxes in respect of 1943. The trustees have been advised and believe that the debtor and trustees have no liability for such taxes. Pending a final settlement of the question with the Commissioner of Internal Revenue, a reserve fund for contingent tax liability was established by order of the court, dated March 3, 1944, in the amount of $7,100,000,

(Testimony of Frank C. Nicodemus, Jr.)
which fund was invested in United States Treasury securities."

And I hand the document to the witness and ask if he recalls seeing that document at or about the time it was received in his office.

(Document handed to witness through Clerk.)

A. I make the same answer; this document undoubtedly came to me in the regular course of business. It was the report of the trustees, submitted over the signature of Mr. Allan P. Matthew, counsel. There was no special reason why I should scrutinize it.

Q. You have no recollection of seeing that portion of the document? A. I have not. [896]

Q. Mr. Nicodemus, I hand to you Interveners' Exhibit 32-A, and Interveners' 32-B; Interveners' 32-A being a letter from Mr. Curry to Mr. Polk, copy to Mr. Nicodemus, of May 19, 1944; and Interveners' 32-B being an enclosure referred to in Interveners' 32-A. Now, the enclosure is a letter of May 17, 1944, from Robert L. Whittaker & Co., addressed to Western Pacific Railroad Corporation, 37 Wall Street, New York, saying:

"Gentlemen:

"It has occurred to us as holders of Western Pacific fives, due 1946, that the large tax credit in the earnings statement for December, 1943, of the Western Pacific, could take place annually for some years to come, as long as the revenue act allows

(Testimony of Frank C. Nicodemus, Jr.)

holding companies to consolidate their returns of subsidiaries for income tax purposes. Since the ownership of the Western Pacific Railroad was declared valueless for 1943, we thought possibly this loss, which must involve upwards of $50,000,000, could be used as a tax credit for future years until the total loss is used.

"We would appreciate hearing from you regarding this situation."

And I ask you if you recall receiving those papers at or about that time. That is to say, particularly 32-B.

(Documents handed to the witness by the clerk.) [897]

A. I recall them. I can identify this as a letter that was produced from my files, and I undoubtedly received it at or about the time of its date, and noted that the matter had partly been referred by Mr. Curry to Mr. Polk. Whether or not I examined the letter from Whittaker or not, I can't remember at this late date.

Q. Do you have any recollection that the Whittaker letter, which came to your office and you saw, brought anything to your mind in referring to a tax loss that might be taken over the years?

A. I say, I don't remember reading the Whittaker letter.

Q. You have no recollection of it?

A. I have no recollection of having read it.

Q. Now, I direct your attention to the Inter-

(Testimony of Frank C. Nicodemus, Jr.)

veners' Exhibit 5, which is a letter dated February 21, 1945, from Mr. Curry to you.

But I am getting ahead of myself, your Honor. I should offer it in evidence, and now do offer the two letters just produced as Defendants' Exhibit 13—being Interveners' 32-A and -B.

(Letters formerly identified as Interveners' Exhibits 32-A and -B were received in evidence and marked Defendants' Exhibit 13.)

Mr. Adams: May the witness please have Plaintiff's 5—or, rather, Interveners' 5—no, not Interveners'—— [898]

Mr. Clark: Now, is that Interveners' 5 on deposition or trial exhibit?

Mr. Adams: Yes, Interveners'. I understand this is the trial exhibit. The letter of February 21, 1945, addressed by Mr. Curry to Messrs. Pierce & Greer is what I refer to.

(Handed to witness by the clerk.)

Q. (By Mr. Adams): Mr Nicodemus, your office received this at or about its date, did it not, this letter of February 21, 1945?

A. This is a copy of a letter which I assume I received, or the original, or that the firm did.

Q. Yes. And I direct your attention to the third paragraph of the letter. Is it a fair statement that the first two paragraphs relate to the Delaware franchise taxes of the plaintiff corporation?

A. It is.

(Testimony of Frank C. Nicodemus, Jr.)

Q. Now, the third paragraph reads:

"The question in my mind is whether we should pay these taxes or let them go by default. If we default and our charter is voided, the question arises what would be the effect on the consolidated income and excess profits tax returns filed by the corporation as parent for the years 1942, 1943 and 1944."

Then the words "To May 1" in parentheses is crossed out. [899]

"As you know, a very large deduction was taken in 1943, which wiped out any tax liability for that year; and will also have an effect upon the 1942 and 1944 consolidated returns. I understand the total tax saving to the Western Pacific Railroad Company will amount to about $15,000,000. Therefore I feel the payment or non-payment of these franchise taxes must be determined, particularly from the Federal income tax angle.

"I would suggest that before arriving at a decision in this matter, you confer with the firm of Whitman, Ransom, Coulson & Goetz, our tax counsel, who are aware of this situation and are considering the consequences which the non-payment of these franchise taxes would have from an income tax viewpoint."

Now, do you recall the portion of the letter that I have just read to you?

A. No, I do not, Mr. Adams, and this is a subject that was ordinarily dealt with by my partner, Mr. Campbell.

(Testimony of Frank C. Nicodemus, Jr.)

The Court: That letter was written by Mr. Curry in what capacity?

Mr. Adams: As president of the parent corporation. This is plaintiff corporation's letter to its counsel, Messrs. Pierce & Greer. [900]

Mr. Clark: Suggesting that the matter be referred to its tax counsel, Messrs. Whitman, Ransom, Coulson & Goetz.

The Court: Well, they were also counsel for the defendant, too, at the same time.

Mr. Adams: Whitman, Ransom, Coulson & Goetz had been engaged by the reorganization trustees to handle these tax matters.

The Court: Well, it is certainly much to the advantage of the defendant company to see to it that the plaintiff company maintained its corporate status, in order that the affiliated return might have effect at the time, isn't it?

Mr. Adams: Well, it isn't a question of whether the affiliated return might have effect; I don't think that the corporate existence was indispensable to that, but it certainly meant that as far as the handling of tax matters was concerned, if the corporation should be dissolved, there would simply be some practical impediments in the way of getting trustees' signatures and all that sort of business.

The Court: No, but they were talking about taxes, weren't they, there in that letter?

Mr. Adams: Yes.

The Court: So the only value attached to keep-

(Testimony of Frank C. Nicodemus, Jr.)

ing the corporation alive was so that the effectiveness could be had with respect to the income tax return?

Mr. Adams: Well, I don't think that is true, your Honor; [901] just simply that there was a relationship between the two things.

The Court: Well, what other thing of moment, what other thing of value, was there?

Mr. Adams: Well, Mr. Nicodemus has said that the plaintiff corporation has been a successful litigant in the suit against the RCC.

The Court: Well, it might have some other reasons, but he did refer in this letter, though, to the income tax returns.

Mr. Adams: That is just right, that is just it.

The Court: I don't quite see the purpose of this.

Mr. Adams: To remind Mr. Nicodemus that here is another piece of notice of all these facts in something that came to his office on February 21, 1945, and to inquire if in any way it refreshes his recollection as to his knowledge with regard to that matter. [902]

* * *

The Court: All right. Go ahead, Mr. Adams.

Mr. Adams: Just one or two more items, your Honor. May I have Defendants' Exhibit 17 upon the depositions?

(Handed to counsel by the clerk.)

Q. (By Mr. Adams): Mr. Nicodemus, I show

(Testimony of Frank C. Nicodemus, Jr.)

you Defendants' Exhibit 17, introduced upon the depositions; your letter of [905] September 12, 1944, addressed to Mr. Ehrman. I will read a little part of this. It begins:

"Dear Mr. Ehrman:

"From your letter to Mr. Schumacher, which he was good enough to show me, it seems evident that there is a lack of understanding in San Francisco of the nature and extent of the services rendered and being rendered by our firm as counsel for the Western Pacific Railroad Company. These services are under employment for the railroad company, continued by the trustees. They may be roughly placed in four general categories, which I will set out below, in which seems to me to be the order of their importance."

Then I will pass over No. 1 and 2 as designated here and refer to the paragraph on page 2, beginning:

"3rd. Services rendered in the matter of Federal taxation"——

Mr. Phleger: Excuse me. If you want to refer to this, read the whole letter. It is a fine letter.

Mr. Clark: Or if it is going to be read from, your Honor, may we have it in evidence, and then counsel may read such portions as he wants.

The Court: I take it this is the letter counsel is just going to offer in evidence; is that your wish? [906]

Mr. Adams: Right, your Honor.

(Testimony of Frank C. Nicodemus, Jr.)

Mr. Clark: If it is going to be offered in evidence, all right.

The Court: What was the date again?

Mr. Adams: September 12, 1944. Of course, your Honor can see the whole letter, but I think I am privileged to read a portion, and in the exercise of that privilege I am following the example that has been set here by able counsel.

(Continuing reading):

"3rd. Services rendered in the matter of Federal taxation. All tax returns for the Railroad Company and the Trustees have been made from New York under advice of New York counsel. Owing to the heavily increased tax burdens incident to the war economy, the complex Federal tax structure and the necessity of recurring conferences with the Commissioner of Internal Revenue and the Treasurer, the firm of Whitman, Ransom, Coulson & Goetz, on our advice, were brought in a year or more ago as tax consultants. They are peculiarly well equipped to serve in that capacity.

"The responsibility of New York counsel for the Railroad Company has not, however, been limited to work under the existing tax laws, but has required constant attention to proposed changes that [907] might adversely affect our property. In the last Congress, the so-called 'Johnson Bill' was orginally so drawn that it would deprive the Western Pacific of the invaluable carry-over and carry-back provisions of the present act. Our firm

(Testimony of Frank C. Nicodemus, Jr.)

prepared and submitted amendments to protect the situation, which Senator Johnson accepted. At the present time legislation is in process of incubation, which, unless the interests of the Western Pacific are guarded, may prove equally embarrassing."

That ends the paragraph under that heading.

Q. I will ask Mr. Nicodemus if, where reference is made to New York counsel for the railroad company, he refers to his firm; and I will ask that the document be exhibited to the witness.

(Document handed to witness.) [908]

The Witness: Is there any particular part of the letter you want me to read?

Q. I want you to have a fair opportunity to look at it because I will have one or two questions to ask, but if you would prefer me to ask the questions and then look, either way is satisfactory. Shall I ask the question, Mr. Nicodemus?

A. Go ahead.

Q. Directing your attention in particular to the first sentence in that paragraph third that I read, "All tax returns for the railroad company and for the trustees have been made from New York through the advice of New York counsel"—do you find that?

A. That is correct.

Q. Were the tax returns to which you referred in that sentence the returns for the year 1943 and prior years? A. 1942 and prior years.

Mr. Adams: May I refer the witness to his deposition, page 1220?

(Testimony of Frank C. Nicodemus, Jr.)

The Witness: Oh, date of this letter is September 12, 1944.

Q. (By Mr. Adams): Yes. Is your recollection refreshed by that? A. It is, yes.

Q. Would you like to answer again the question I just put? What were the tax returns to which you referred in that sentence [909] of your letter?

A. The tax returns for 1942 and 1943.

Q. Does that refresh your recollection in any way, Mr. Nicodemus, that you were aware at that time of the fact that in the tax returns for 1943 the stock loss of the parent corporation had been taken as a deduction, so that no tax liability was shown in the returns?

A. No, it does not, because the returns were made under the immediate direction of Messrs. Whitman, Ransom, Coulson and Goetz.

Q. Is that the reason why it does not refresh your recollection?

A. And I have no recollection of any discussion as to the 1942 returns—1943 returns.

Q. Mr. Nicodemus, prior to October, 1946——

The Court: This is defendant's 14 now?

Mr. Adams: Thank you, your Honor, yes. I will offer it as Defendant's 14, and perhaps it would be an appropriate time to take a recess. I will have a very brief examination to conclude in the morning. I say very brief; not over a half hour, I think.

(Testimony of Frank C. Nicodemus, Jr.)

(The document referred to was thereupon received in evidence and marked Defendant's Exhibit 14.) [910]

* * *

Q. Prior to the time when the stockholders' suit that we have talked about was instituted in New York, in the middle of 1946, the VanKirk litigation, did you ever suggest to Mr. Polk or [911] to Mr. Coulson that either of them had any obligation to advise the corporation of possible claims among group members arising out of the tax returns? A. Prior to that?

Q. Yes.

A. I did not. I assumed under the contract of employment of the firm of Whitman, Ransom, Coulson and Goetz that they were under obligation to advise me of any unusual circumstances connected with the federal tax return.

Mr. MacKinnon: I move to strike out everything after "No, I did not," on the ground it is not responsive.

Mr. Phleger: May I suggest, your Honor, that that is a perfectly proper answer because this is an adverse witness, and the implication of the question is that it was his obligation to have asked them.

The Court: I will deny the motion. The wording of the question was such that I think the answer is not unresponsive.

Q. (By Mr. Adams): Mr. Nicodemus, prior to

(Testimony of Frank C. Nicodemus, Jr.)

the time that this suit began, did Mr. Polk or Mr. Coulson ever refuse to provide you with any information that you requested in connection with the tax transactions?

A. So far as I know, I never requested any.

Q. Your recollection is you never made any requests of them for any information with regard to those matters prior to that time?

A. I assumed the obligation was the other way. [912]

Mr. MacKinnon: I move to strike that out on the ground it is not responsive.

The Court: He has already answered that question. I will strike out the answer on that ground. He has already said he did not make any such requests.

Mr. Adams: Your Honor's point is he has already said that?

The Court: In the previous answer he already said that.

Mr. Adams: As long as the record shows that, that is all I am interested in.

Q. Now, Mr. Nicodemus, do you recall receiving advice in April, 1947, that a settlement proposal had been made to the Bureau of Internal Revenue?

A. I do.

Q. Were you advised of the terms of the proposal? A. I was.

Q. You know, did you not, that the corporation was free to accept or reject the settlement proposal

(Testimony of Frank C. Nicodemus, Jr.)

as it might see fit? A. Restate that question.

(Question read.)

A. I think I did understand that at that time.

Q. Now, considered only from the point of view of settling the claim with the government and leaving out of account any inter-company complaints about the matter, did you consider the settlement was a good one? A. I did.

Q. Was that the judgment of your fellow directors? [913]

A. I can't speak for my fellow directors except that they voted ultimately to accept the settlement.

Q. You were a member of the committee of Mr. Osborn, Mr. Wood and yourself which considered this very matter, were you not?

A. We did. We were a committee.

Q. Did you seriously consider withdrawing Mr. Polk's power of attorney and refusing to go along with the settlement?

A. I do not think that was discussed.

Q. And did the Board of Directors of the corporation finally agree with the settlement and approve it?

A. I think there is a resolution in the record that covers that.

Q. Prior to that time you gave full consideration to the problem, did you not, as to what action the Board of Directors should take?

A. Yes, sir.

Q. And prior to that time you and Mr. Osborn,

(Testimony of Frank C. Nicodemus, Jr.)

with Mr. Goodrich acting in behalf of the corporation, took up and discussed an arrangement to obtain a stipulation which eventuated in a stipulation here in court? A. We did.

Mr. MacKinnon: You had better have the question read back. You referred to Mr. Goodrich.

The Witness: That is correct. Mr. Goodrich testified to it. [914]

The Court: Mr. Goodrich was one of the attorneys at that time.

The Witness: At the present time.

Q. (By Mr. Adams): Mr. Nicodemus, was the Board of Directors of the Corporation at all times aware of the fact that in the reorganization you were acting as attorney for the debtor, and that you were in receipt of compensation from the trustees on a salary basis? A. They were.

Q. Did they know that you were advising Mr. Schumacher as trustee from time to time on an informal basis? A. They did.

The Court: May I ask a question there? You referred to that as an informal basis and some other lawyer said that account was approved in the reorganization proceeding.

Mr. Adams: No, your Honor. As attorney for the debtor—Mr. Nicodemus can tell us about this—I will state it and see if I am right—as attorney for the debtor, Mr. Nicodemus received allowances approved by the Interstate Commerce Commission and by the court.

(Testimony of Frank C. Nicodemus, Jr.)

Q. That is correct, is it not, Mr. Nicodemus.

A. That is correct.

Q. Under the order of Judge St. Sure the firm of Pierce & Greer received a monthly salary payable by the railroad organization in the hands of the trustees, just as it had prior to reorganization. [915] That is a different matter. They received both of those compensations, the firm did. That is right, is it not, Mr. Nicodemus?

A. That is correct.

Q. Prior to June 1, 1943, the firm of Pierce & Greer also received a monthly salary from the parent corporation, is that right, Mr. Nicodemus?

A. I believe it is. [915A]

Q. And then after June 1, 1943, that monthly salary, which by that time had been reduced to some $416.66 a month, was paid by the trustees in reorganization, whereas prior to that time it had been paid by the plaintiff corporation. I am not sure of my figures, but I am certain of the fact, and I think Mr. Nicodemus will agree that the full compensation of Pierce & Greer, which had formerly been split between the company and the corporation, was taken over by the court's trustees at that date.

Mr. Clark: Some part of it.

The Court: I was asking about it. You had mentioned the fact that this witness was acting informally as attorney for Mr. Schumacher. I recall that one of the attorneys said that that com-

(Testimony of Frank C. Nicodemus, Jr.)

pensation was approved in the Bankruptcy Court. Is that right?

Mr. Phleger: That is right.

Mr. Adams: I think that is a mistake.

Mr. Phleger: Not as a separate item, but they were in receipt regularly of compensation from the trustees for services rendered the trustees, and those accounts were periodically filed and approved by the Bankruptcy Court.

The Court: Is that something different from services rendered to the debtor company?

Mr. Phleger: No, not separately—yes, the debtor in bankruptcy. In that category they received a separate fee, [916] did they not?

Mr. Clark: And allowances.

Mr. Adams: There are three compensations. Now, compensation as attorney for the debtor—and in that capacity, Mr. Nicodemus, the fact is——

The Court: All I was trying to find out is why you were calling these services to the trustees informal. If he represented the trustees and he got paid for the services in the Bankruptcy Court, then he represented them. That is all there is to that.

Mr. Adams: I had better answer that question to your Honor direct. I call it informal to distinguish the formal, the legal representation of the trustees by the counsel appointed by the Court to be the counsel to the trustees. Mr. Nicodemus did not act in that position.

The Court: He was not the court-appointed attorney for the trustees?

(Testimony of Frank C. Nicodemus, Jr.)

Mr. Adams: That is right. That is all I had in mind.

The Court: He represented the debtor, for which he was paid a fee, and he also rendered services to the trustees, is that right?

Mr. Adams: Yes, surely. Yes, indeed, on a monthly basis.

The Court: That was approved and authorized by the Bankruptcy Court, as I understand it?

Mr. Adams: Yes, your Honor, and there is a special [917] bankruptcy order, No. 40, I believe it is, which prescribes in Section 77 proceedings it is appropriate to continue company lawyers.

The Court: It is not unusual in proceedings of that kind where the attorney for the debtor is employed to render services to the trustee in bankruptcy. It sometimes happens, particularly where there is litigation involved and other matters of a special kind.

Mr. Adams: It was only in that sense that I was using the word "informal," and perhaps I can think of a better word to describe this by.

Mr. Phleger: We could think of a better word.

Mr. Adams: That may be the time to speak, because we are going to get into some issues about this.

Q. We were talking about this date, June 1, 1943, Mr. Nicodemus, when the trustees undertook to pay all the expenses of the New York office, including whatever monthly sum your firm had

(Testimony of Frank C. Nicodemus, Jr.)

previously been receiving from the plaintiff corporation. Do you have that in mind?

A. Will you state that again?

(Question read.)

A. I don't understand the question.

Q. I asked you if you had those facts in mind.

A. I wish you would reframe the question. I do not know what the answer is. What facts?

Q. You bear in mind that on June 1, 1943, the salary that your [918] firm had previously been receiving from the plaintiff corporation as its counsel was taken over by the reorganization trustees?

A. I recall that, yes.

Q. And thereafter and until the end of the reorganization, the reorganization trustees paid that salary? A. I recall that.

Q. After that arrangement was made did you still feel entirely free to represent whatever interest of the plaintiff corporation you thought required action on your part as its counsel?

A. I do not know that any question of that kind ever arose in my mind.

Q. Do you have any idea about it one way or the other? If you have, you are on the stand and you can answer.

A. No such question ever arose in my mind.

Q. Do you mean by that, Mr. Nicodemus, that it never occurred to you that that arangement in any way impaired your ability to act for the plaintiff corporation?

(Testimony of Frank C. Nicodemus, Jr.)

A. No, I had been acting for the plaintiff corporation and for the trustees and for the debtor since the beginning of the proceeding under Section 77 in 1935.

Q. And during all of that time, Mr. Nicodemus, the fact is, is it not, that you felt that you were able to and that you felt that you did represent the corporation's claims to the best of your ability? [919] A. I did, yes.

Q. And that you still thought you were in a position to do that after this arrangement was made on June 1, 1943?

A. I did not think it changed the situation.

Q. Were you aware of the arrangement that Mr. Curry made with the firm of Whitman, Ransom, Coulson & Goetz on or about the 1st of May, 1945, whereunder he was to receive a retainer and have an office in their suite? Do you recall knowing about that?

A. I recall knowing that he was to have an office in that suite, but I do not recall the arrangement and the retainer.

Q. When you say you do not recall that, do you mean you had never heard of it until this time?

A. I never heard of it until the institution of the stockholders' suit.

Q. Is it your best recollection that Mr. Curry did not tell you about that until after the institution of the stockholders' suit?

A. That is my very definite——

(Testimony of Frank C. Nicodemus, Jr.)

Q. That you never discussed that with Mr. Schumacher?

A. That is my very definite recollection.

Q. Do you have any recollection of talking to Mr. Schumacher at the time the New York office closing was under consideration about what would be done for Mr. Curry?

A. No, I do not. [920]

Q. You have no recollection of considering that at all?

A. I can recall no particular discussions on that subject.

Q. Any discussion of it between you and Mr. Osborn?

A. Not that I recall at the present time.

Q. Did you ever suggest to Mr. Coulson that something should be done for Mr. Curry?

A. I did.

Q. When did you do that?

A. Sometime in the fall of 1944 Colonel Coulson told me that he was arranging to take over certain of the employees of the railroad company, that he was arranging for a pension for Mr. Schumacher, but that he did not feel under any obligation to look after Mr. Curry. I told him that I thought that that was rather raw treatment for Mr. Curry, and that he was just as much entitled to a pension as Mr. Schumacher. He said he did not agree with me. He felt no particular obligation to Mr. Curry.

(Testimony of Frank C. Nicodemus, Jr.)

Q. Is it your testimony that you never discussed doing anything for Mr. Curry with Mr. Schumacher at any time?

A. No, I do not recall that I ever did.

Q. You have no recollection of any such discussion?

A. No, but I do recollect this conversation with Colonel Coulson very distinctly.

Q. Yes, and you have told me about that. Have you stated your complete recollection with regard to that conversation? [921]

A. I have, the substance of it.

Q. Yes. Have you anything more to add to it?

A. Nothing to add to it.

Q. Is it your testimony, then, that although you knew Mr. Curry was officing in the Whitman, Ransom suite, you hadn't any idea that he was receiving any retainer from them or from the railroad company? A. No.

Q. Is that your testimony?

A. I learned afterwards that there had been some pension arrangement, but I never heard of this so-called independent contractor arrangement until after this stockholders' suit was instituted.

* * *

FRANK C. NICODEMUS, JR.

Direct Examination
(Resumed)

By Mr. Adams:

Q. May I ask that the transcript of yesterday's testimony be presented to Mr. Nicodemus, and I direct his attention to a question and answer on page 914?

(Court's copy of transcript was handed to witness.)

Q. (By Mr. Adams): Mr. Nicodemus, directing your attention to the testimony beginning two lines from the top of 914, as reported in this transcript:

"Q. You were a member of the committee of Mr. Osborn, Mr. Wood and yourself which considered this very matter, were you not?

"A. We did. We were a committee.

"Q. Did you seriously consider withdrawing Mr. Polk's power of attorney and refusing to go along with the settlement?

"A. I do not think that was discussed."

A. That answer is incorrect. [923]

Q. I did not hear that answer that way, and I wanted to give you a chance to answer it again.

A. That is not correct. The answer is, "I think that was discussed."

Mr. Adams: I have no further questions.

The Court: Any questions by other counsel?

Mr. Adams: Pardon me, your Honor; I think

(Testimony of Frank C. Nicodemus, Jr.)

it would be appropriate, before I conclude this examination, to offer a document which I referred to yesterday, so that if counsel wish to ask the witness or examine this document, it may be on the record upon this examination. I now offer as Defendant's Exhibit 15 a letter from Mr. Ehrman to Mr. Nicodemus of September 14, 1944, written in response to Mr. Nicodemus' letter of September 12, 1944, to Mr. Ehrman, which went into evidence yesterday.

(Letter from Mr. Ehrman to Mr. Nicodemus, dated September 14, 1944, referred to above, was received in evidence and marked Defendant's Exhibit 15.)

Mr. Adams: The letter reads as follows (reading). This is from San Francisco:

"Mr. F. C. Nicodemus, Jr.
Messrs. Pierce & Greer
40 Wall Street
New York 5, New York

My dear Mr. Nicodemus:

"I am in receipt of your letter of September 12 going into some detail in regard to the nature and extent of [924] the services which are being rendered by you on behalf of the Western Pacific Railroad Company and its trustees. I wrote to Mr. Schumacher after you had filed your petition so that if both of us are called by the judge at the hearing on the subject of your compensation, our testimony would be in harmony. I have always

(Testimony of Frank C. Nicodemus, Jr.)

been under the impression that the monthly compensation paid to your firm is the only compensation for which the trustees or the trust estate have incurred any liabilities. Your representation to the debtor company in the reorganization proceedings is, as I view it, a separate matter with which we as trustees are not concerned.

"With kind regards,

"Very truly yours,

"SIDNEY M. EHRMAN."

And at this time, your Honor, I offer as Defendant's 16 the form 174 revised, operating results and general statistics, the Western Pacific Railroad Company, which I discussed with the witness yesterday, and which is the document upon which appears the item reversing the federal income taxes.

The Court: Has it a date?

Mr. Adams: It is identified at the bottom in print, "San Francisco, California, February 1, 1944," and at the top, "operating results and general statistics, December, 1943." [925]

(The document referred to was thereupon received in evidence and marked Defendant's Exhibit 16.)

Mr. Adams: I have nothing further.

Mr. Phleger: Mr. Clerk, will you please hand Plaintiff's Exhibit 39 to the witness, or let me have it.

(Testimony of Frank C. Nicodemus, Jr.)

Cross-Examination

By Mr. Phleger:

Q. Plaintiff's Exhibit 39A, Mr. Nicodemus, is a letter on the letterhead of the Western Pacific Railroad Company, 37 Wall Street, New York; T. M. Schumacher and Sidney M. Ehrman, Trustees, dated March 23, 1943, addressed to Mr. F. C. Nicodemus.

"Dear Mr. Nicodemus:

"Mr. Curry has told me of the talk he had yesterday about the consolidated income tax return of the Western Pacific Railroad Corporation and its subsidiaries for the calendar year 1942. The return filed is a tentative one, an extension having been granted until May 15, 1943, to file a final return. As one of the trustees of the Western Pacific Railroad Company, I am looking to you to cooperate with Mr. Matthew, general counsel for the trustees, in protecting the trust estate in the preparation of the final return.

"Very truly yours,

"T. W. SCHUMACHER."

Did you receive that letter at or about its date?

A. I did. That is T. M. Schumacher.

Q. I direct your attention to the succeeding sheets in Plaintiff's Exhibit 39. 39B is a letter which you wrote to Mr. Schumacher, is it not, under date of March 23?

A. The file handed me shows a letter dated April 20.

(Testimony of Frank C. Nicodemus, Jr.)

Q. 39B is a letter which you wrote to Mr. Schumacher under date of March 23 in respect to the letter I have just read?

A. That is correct.

Q. And in that you suggested the employment of Mr. Coulson's firm as tax experts in this matter?

A. That is correct.

Q. I will not read the succeeding letters but will call your attention to the final letter in the series, being Plaintiff's Exhibit 39F.

A. I have 39F.

Q. That letter reads as follows, on the letterhead of the Ransom firm, under date of April 20, 1943, addressed to yourself, signed by Mr. Robert E. Coulson, reading as follows:

"Dear Mr. Nicodemus:

"This is a belated acknowledgment of your letter of April 8, 1943. I had assumed from its text and from the fact that Mr. Polk and you were already at work when I received your letter that you needed no formal acknowledgment. However, it may be better as a matter of record that you should have a formal acknowledgment of [927] the fact that we have undertaken the federal tax work for the trustees as advisory counsel in conjunction with yourself and Mr. Matthew."

Did you receive the original of that letter at or about its date? A. I did.

Mr. Phleger: That is all.

Mr. Clark: May it please the Court, we have

(Testimony of Frank C. Nicodemus, Jr.)

just one exhibit to offer in connection with Mr. Nicodemus' testimony regarding his employment by the reorganized company after December 31, 1944, and in that connection we will offer in evidence a copy of a letter heretofore marked Interveners' Exhibit 331 on deposition, dated June 8, 1945, addressed to H. E. Poulterer by J. E. Hennessy. Plaintiff's Exhibit 25 already in evidence, your Honor, shows that Mr. Poulterer was the vice president of the defendant company in charge of traffic in San Francisco.

Mr. Adams: That is right.

Mr. Clark: And I would like a concession from you, Mr. Adams, that Mr. Hennessy was the representative of the defendant company in New York in charge of traffic.

Mr. Adams: Well, Mr Hennessy was a representative of the railroad company. Whatever his description is I am not sure, but that is what you want, isn't it?

Mr. Clark: That is all I want. [928]

Mr. Adams: May I state an objection to this offer, your Honor? This is an offer which relates to certain legal services performed by Mr. Nicodemus and his firm for the reorganized company, but Mr. Nicodemus testified yesterday that he did carry over some legal services, and he did do some work for the railroad company; this is an offer relating to that. My objection is that it is wholly immaterial to any issue in this case. That Mr.

(Testimony of Frank C. Nicodemus, Jr.)

Nicodemus may have had some employment with regard to matters for the reorganized railroad company is wholly unrelated to any matter in issue in this action. I see nothing inconsistent between his carrying on some ordinary work wholly disconnected with any matter in which the corporation was interested, his availability to act in behalf of the plaintiff corporation at all times, nor is there any duality that arises from the employment of an attorney of that sort.

Mr. MacKinnon: I object to it, your Honor, on the ground it is irrelevant and immaterial to any of the years in question and to the issues which I understand your Honor has stated you consider in the action, namely, the tax question for the years 1942, 1943 and the first four months of 1944.

Mr. Clark: May I direct your Honor's attention to the testimony of the witness yesterday which Mr. Adams solicited, and with respect to it this offer is being made, at page 844 of yesterday's transcript, line 2:

"Q. It is a fact, is it not, that your employment as [929] a counsel for the railroad company terminated as of the end of 1944?

"A. December 31, 1944, except as to minor matters.

"Q. You did continue to handle a few minor matters which were then in your hands?

"A. A few minor matters which were in my hands and one or two still pending, I think."

(Testimony of Frank C. Nicodemus, Jr.)

Then there is colloquy of counsel and here is the next question:

"Mr. Adams: Mr. Nicodemus, the fact is, is it not, that you received a letter from Mr. Elsey, the president of the reorganized company, to be late in December, 1944, which informed you that the reorganizing company did not expect to continue with the services of the firm of Pierce & Greer?

"A. My answer is my relationship as corporate counsel was terminated as of December 31, 1944, with the reservation that we would continue to handle certain matters that were pending.

"Q. That were pending with you, and you did continue to handle such matters?

"A. We have.

"Q. And it was as to such matters that you sent special bills to the railroad company which were paid."

Now, the letter which I am offering, may it please the Court, shows that in the middle of 1945 the company advised Pierce & [930] Greer, or rather people in the company were told that in the event legal process should be served on the company, he was to turn such matters over to Mr. Campbell of the firm of Pierce & Greer. That is the middle of 1945, and we renew the offer. They were not pending matters. They were new matters, and it demonstrates that Mr. Nicodemus' firm was the New York counsel for the reorganized company during the year 1945, just as is demonstrated by the bill Mr. Phleger called your Honor's attention to yesterday,

(Testimony of Frank C. Nicodemus, Jr.)

showing the payment for that year.

The Court: Well, I think counsel's objection goes to the weight of the testimony. I will overrule it.

Mr. MacKinnon: May I be heard on my objection? I don't want to take time on this, because I don't think it is important; but your Honor has stated you perceive the issues in this case to be the tax relationship. That is not the tax relationship, but one year and three months later. Now if that is relevant, then it seems to me we are opening this question wide open.

Mr. Clark: May it please your Honor, the refund claim was filed March of 1945, on March 9. The '44 return was filed as late as June 15, 1945. It is the very time in question.

The Court: Counsel, the witness was interrogated yesterday as to the circumstances under which his employment by the company was or was not terminated.

Mr. MacKinnon: That is right. [931]

The Court: So that you brought that out, or rather, counsel for the defense brought it out. It certainly has something to do with that examination. The objection may be as to the weight of the testimony, but I wouldn't think as to its admissibility.

Mr. Adams: I would just like to state that I offered, or brought it out, because plaintiff has offered in evidence documentary material relating to payments made to Mr. Nicodemus for such purposes.

(Testimony of Frank C. Nicodemus, Jr.)

The Court: It may be admitted.

(Letter of June 8, 1945, Hennessy to Poulterer, was thereupon received in evidence and marked Interveners' Exhibits 17.)

Mr. Clark: That is all from us, your Honor.

The Court: I think that is all.

(Witness excused.) [932]

* * *

Mr. Adams: Reading from page 4570 of the deposition of Willis D. Wood, taken in this action in New York, commencing April 20, 1948.

"WILLIS D. WOOD

"called as a witness by the plaintiff, being first duly sworn by the notary public and stating his address as 635 Park Avenue, testified as follows."

And then on page 4572:

"Q. In 1898 did you go to work for a different firm? "A. I formed a firm in 1898.

"Q. What was the name of the firm that you formed? "A. Ladd, Wood & King.

"Q. What was the business of the firm?

"A. The same.

"Q. Brokerage business, investment business?

"A. Yes.

"Q. How long did that firm continue?

"A. Ladd, Wood & King were on for about four years, and then Ladd & Wood until about 1924.

"Q. Did you form the firm of Ladd & Wood?

"A. Yes.

"Q. And that was a brokerage business?

"A. Continuing the same business." [933]

To shorten this, may I ask if counsel will agree with me that then Mr. Wood stated that the name became "Wood, Low & Co." in 1924 and that firm remained in business until 1941, and that thereafter Mr. Wood became a limited partner in a similar firm? Turning to page 4574, again to shorten the reading——

Mr. MacKinnon: You haven't gotten your concession.

Mr. Phleger: Yes, certainly.

Mr. Clark: Yes.

Mr. MacKinnon: All right.

Mr. Adams: Mr. Wood's deposition, page 4574, shows that he is a member of the New York Stock Exchange, becoming such in 1902, and is now and was a governor of the Exchange from 1911 to 1927, and was for eleven years a member of the listing committee. Is that conceded?

Mr. Phleger: Yes.

Mr. Clark: Yes.

Mr. Adams: I am continuing on the following pages. Also, that he has been a director of several corporations, a trustee of the Brooklyn Trust Company, a director of the Corn Products Refining Company, having been a director on that company since 1915, when it was organized; a director of the Fidelity & Casualty Company, on which he has been a director from 1925 to the present date. And

on page 4579, a director of the Missouri, Kansas, Texas Railroad Company from its reorganization in 1923 to his resignation in 1946; a director of the New York Railways Corporation [934] from 1925 to date. That is page 4580. And the following questions and answers on page 4581, beginning three lines from the top of that page:

"Q. Mr. Wood, have you had anything to do with the Seaboard Airlines during its reorganization?

"A. I was the only man who lived through it, thirteen years.

"Mr. Levy: Is that the one that was just completed?

"The Witness: Yes.

"Q. (By Mr. Dickerson): Were you a member of the reorganization committee?

"A. The entire time."

Now turning to page 4583, I will read from that page, beginning at the top. Question by Mr. Dickerson who was, as your Honor knows, of counsel to the plaintiff:

"Q. Mr. Wood, did anyone ask you to become a director of the Western Pacific Railroad Corporation? "A. Mr. James.

"Q. Do you remember the conversation that you had with Mr. James at that time?

"A. I remember having a conversation with Mr. James, asking me to become a member of the board, surely.

"Q. What was the conversation? Give us the substance of it, if you remember.

"A. The substance of it was that, as a matter of fact, [935] he knew how well informed I was about that district. I had known the properties of the Denver & Rio Grande for ten years before. I saw him continuously, socially, and talked to Mr. James about it. And he knew I went out there every year on the Denver & Rio Grande situation and I knew a good deal about it. And he wanted me to join the board for those reasons."

Page 4590, question four lines from the bottom of that page:

"Q. Did you know Miss M. C. Valouch?

"A. Same way."

I had better read above, your Honor, to see what that answer means, I suppose .

Mr. Phleger: What page is that?

Mr. Adams: 4590. At the top of the page, the second line, is this:

"Q. Mr. Wood, did you know Mr. John F. Wienken?

"A. As a director of the board.

"Q. Did you know him prior to the time he became a director of the board?

"A. No, excepting when he was working in the office there.

"Q. This was at 37 Wall Street?

"A. Yes."

I think counsel will agree that the answer "same way" relates to those answers? [936]

Mr. Phleger: Yes.

Mr. Clark: That's right.

Mr. Adams (reading):

"Q. You knew her in the office at 37 Wall Street, did you?

"A. Yes, her time wasn't wholly given to that. I had met her in connection with Western Pacific matters before she became a director. I cannot tell what the occasion was, but I was very happy to see her become a director; I admired her as a person."

The record shows that Miss Valouch became a director of the plaintiff corporation May 1, 1945.

Mr. Phleger: Which is about the time of this communication that has just been objected to.

Mr. Adams: Well, I am giving the dates, your Honor, and I think that I might proceed without these interpolations.

Page 4666 of Mr. Wood's deposition:

"Q. Did you know the reputation of Mr. James for fair dealing? "A. Yes.

"Q. What was that reputation?

"A. One of the most generous souls I ever knew. He inherited it from his father. I know, for instance, in Mr. D. Willis James' will, he provided that his beneficences should not be known until twenty-five [937] years after his death. I knew of the generosity of Mr. A. C. James and it was greater than people ever had any idea.

"Q. And in his business transactions, Mr. Wood, what was his reputation as to fair dealing in his business transactions? "A. The best.

"Q. You spoke yesterday of Mr. James speak-

ing to you about becoming a director of the corporation. Do you recall that? "A. Yes.

"Q. Was it your understanding that Mr. James expected you to exercise your best judgment in your acts as a director?

"A. He wouldn't have asked me if he hadn't thought so.

"Q. Did he ever tell you how to vote on any matter that came before the Board of Directors?

"A. No, sir. I discussed the wisdom of policies with him, but he never attempted any dictation.

"Q. So far as you know, did he ever give you any orders or directions to other directors as to how they should vote? "A. No.

"Q. Did Mr. James ever ask you to favor the James interests at the expense or disadvantage of other stockholders [938] of the corporation?

"A. No.

"Q. Did he ever ask you to do anything which you believed would favor the James interests at the expense or disadvantage of other stockholders?

"A. No.

"Q. Have you, as a director, ever done any act for the purpose of favoring the James interests at the expense or disadvantage of stockholders of the corporation? "A. No."

Mr. Levy: There was an objection to the form of the question at that time, your Honor, on the ground that it called for a conclusion of this witness and character of his own conduct, rather than a statement of the facts. I should add that while we have not objected to any of what Mr. Adams has

read, your Honor will be mindful that Mr. James died in 1941, so that all Mr. Adams' questions here are directed to a period preceding 1941.

Mr. Adams: That is not true, as to the last question, not accurate, Mr. Levy.

Page 4669, question at the top of the page——

Mr. Levy: I don't think we have a ruling on the objection.

The Court: I don't know whether you are objecting to it or not.

Mr. Levy: Yes, I read the objection as it was stated at the [939] deposition.

The Court: What was the question?

Mr. Adams: "Q. Have you, as a director, ever done any act for the purpose of favoring the James interests at the expense or disadvantage of other stockholders of the corporation?"

The Court: Well, a lot of other questions along the same line were asked heretofore, weren't they?

Mr. Levy: Yes, they have been; just as improperly, I think.

The Court: You didn't object to those.

Mr. Phleger: We haven't objected to many questions that we think are quite improper. We didn't want to delay the trial. I think it is immaterial, your Honor.

The Court: I believe it is immaterial, but I will overrule the objection. I think this line of questioning is immaterial but I will overrule that objection.

Mr. Adams: Page 4669:

"Q. I take it from your testimony that you have known Mr. Schumacher since about 1920?

"A. I think it may have been a little before that, even. I am sure it was before that."

Then further down, same page:

"Q. After you became a director of the Western Pacific Railroad Corporation, did you then see him frequently? [940]

"A. In the duties of the corporation, yes."

Page 4674, six lines from the top of the page:

"Q. Do you recall, Mr. Wood, any discussion you had with Mr. Schumacher in connection with the engagement of Mr. Polk on tax matters?

"A. I had Mr. Schumacher in mind, and I had my associates on the board discuss the matter."

That is the way the transcript reads.

"Q. Do you remember at this time any discussion you had with Mr. Schumacher on that subject?

"A. Not specifically alone, no.

"Q. Do you recall any discussion of that subject with Mr. Nicodemus?

"A. I do not recall any. I would be surprised if I didn't have numerous discussions, but I cannot recall any specific one. They were discussed many times outside of the board room and fully at the board meetings.

"Q. Is it your best recollection that the Board of Directors of the corporation generally knew of the engagement of Mr. Polk in that work?

"A. Yes."

Mr. Levy has an objection he may wish to state.

Mr. Levy: No, we will pass the objection.

Mr. Adams: Very well. That is all I have from the deposition of Mr. Wood. [941]

Mr. Phleger: I take it this is an appropriate time for us to at this time read from the balance of his deposition?

The Court: Well, whatever procedure you wish to follow; unless you wish to wait until a later time. If counsel is willing, I suppose you might.

Mr. Adams: We are entirely willing; whatever procedure would be most advantageous for the Court's point of view.

The Court: It will be in the nature of cross-examination?

Mr. Phleger: In the nature of cross-examination, yes.

The Court: All right.

Mr. Phleger: 4682, question by Mr. Adams:

"Q. When was it, Mr. Wood, that you knew about the railroad company being freed from the 1943 taxes and the first four months of 1944, and about the railroad company paying the $4,200,000 for 1942?

"A. The first time I knew anything about the benefit of that position was in my talk with Mr. Nicodemus in the last part of July, 1946.

"Q. Prior to that time, had you heard anything about the railroad company setting up a reserve on account of its not paying income taxes?

"A. No.

"Q. Prior to the time that you had that talk with Mr. Nicodemus, what was your knowledge with

regard to the taxes that the railroad company was paying? [942]

"Mr. Levy: For the years 1942, 1943 and 1944.

"Mr. Adams: Yes, for those years.

"A. I was a director of the corporation. I felt absolutely confident, as I have said before, that it was a corporation without assets, and I felt I was justified in acting as I did. I had had so long an association with the Denver & Rio Grande that I was positive that there was no value in the stock. I felt there was no duty to perform, excepting to approve a pro forma return to take care of the corporation, and that was my whole idea at that time, and I felt that that function was in competent hands.

"Q. Did you know during those years, 1942, 1943, and 1944, that the corporation had deficits?

"A. Yes, of course.

"Q. Did you assume that then the corporation would not have any income tax liability?

"Mr. Levy: I object to the form of the question as calling for an assumption."

Mr. Levy: Objection withdrawn.

Mr. Phleger: "A. I felt the company was foreclosed, as to preferred and common. The Court acted on March 15, 1943, and after that there was no action necessary on my part, and hence I did not give it the attention that I did in former years. I felt that I did not have to give it [943] the detailed attention that I had formerly given it.

"Q. Was it your understanding that the corporation did not have any taxable income during those years?

"A. I considered it a non-entity. It had no assets; how could it have any income?" [943A]

Mr. Phleger: 4687.

"Q. (By Mr. Adams): Do you recall any discussion with regard to paying the franchise taxes of the corporation?

A. Yes, I do. You mean the Delaware franchise taxes?

Q. Yes, precisely. A. Yes.

Q. Will you state your best recollection as to that discussion?

A. I remember the sum involved seemed to us small, but it was represented, or I recall that I was convinced that it was one of those things that ought to be done, that the corporation was not ready for interment, was not through.

Q. Do you have any further recollection of any further discussion as to why it was desirable to keep the corporation going?

A. No, excepting as I have just stated, I regarded the thing as a pro forma situation for the liquidation of the corporation, which was beyond reviving in my mind as of March 15, 1943.

Q. So far as you can remember at this time you do not remember any discussion with any of your fellow directors that the consolidated returns [944] would be any advantage to the railroad company?

A. No, sir."

4608, near the bottom:

"Q. (By Mr. Dickerson): As to the 1944 return was there any discussion by the board of di-

rectors at any time concerning the capital loss sustained by the holding company which might be used by the group to avoid taxation?

A. No.

Q. Did Mr. Polk or any other member of the firm of Whitman, Ransom, Coulson & Goetz ever explain to you the possibility that the capital loss sustained by the holding company could be used by the group to avoid taxation?

A. No, decidedly."

That is all.

Mr. Adams: I have some responsive reading from the same deposition. Page 4677 of Mr. Wood's deposition.

"Q. Now, I ask you to state, as well as you can recollect it, what was the discussion with regard to the filing of the consolidated returns for 1943?

Mr. Levy"——

Mr. Levy, do you want me to read this?

Mr. Levy: Skip it.

Mr. Adams: Page 4678:

"Q. Do you bear the question in mind, Mr. Wood? [945]

A. What is your question to me?"

Then the question was read.

" 'Q. Now, I ask you to state, as well as you can recollect it, what was the discussion with regard to the filing of the consolidated returns for 1943?'

A. There was never a time when I had any question but that the consolidated returns were filed. They were from the start. I do not recall any

specific question debated or referred to. As to questioning the possible desirability of the corporation's benefit, it never occurred to me. I feel that you are pinning me down by trying to make me recall a specific conversation about a specific subject. I do not recall anything of that kind because it was a continual assumption based on fact that those consolidated returns were filed right through. Is that an answer?"

And then on page 4683, two lines from the bottom, and this immediately follows what plaintiff's counsel just read to your Honor.

"Q. So, it was your understanding that for those years the corporation could not possibly have any income tax? A. Absolutely not.

Q. Did you know that the company during those years [946] had large earnings?

A. The railroad company?

Q. Yes.

A. I knew the progress of the railroad company.

Q. Were you aware that during those years, 1942 and 1943 and 1944, the company was having large earnings?

A. I remember that so well as to feel that an event which occurred in 1931 and which was of great promise for the Western Pacific road, the building of the Klamath Falls division, was beginning to bear fruit many years afterward.

Q. Was it your understanding that any income taxes for those years would be paid by the railroad company?

A. If paid at all, it was the only company that had any money.

Q. And it was likewise, was it not, the company that had the earnings? A. Yes."

Now, if your Honor please, I should like to read from the deposition of William W. Hatton taken in New York on February 19, 1948, in this action, page 712. Your Honor will recall that Mr. Hatton was a director at certain times of the plaintiff corporation, and as in the case of Mr. Wood, I will try to state, without reading the questions and answers, the preliminary statements describing the witness who was called in behalf of the interveners.

Mr. Hatton testified that he was employed at the time of giving his testimony by the Denver and Rio Grande Western Railroad Company with an office at 37 Wall Street; that he had been employed by that company for 25 years; that during 1942, 1943 and 1944 the office of the Denver and Rio Grande was at 37 Wall Street; that his position with the Denver and Rio Grande was assistant secretary and assistant treasurer; and the record shows, your Honor, that that office at that time was the same office occupied by the plaintiff corporation, the New York office we have heard talked of. Now, at page 726 these questions are asked by interveners' counsel:

"Q. Do you remember who it was that asked you to go on the board?

A. I couldn't say. I don't recall.

Q. Do you have any recollection at all on that subject? A. No, only what I think.

Q. What do you think?

A. I think Mr. Curry asked me.

Q. You think it was Mr. Curry?

A. I think, yes.

Q. How long had you known Mr. Curry prior to that [948] time? A. Over ten years.

Q. In what connection, please?

A. In connection with the Denver and Rio Grande being 50 per cent owned by the Western Pacific and more or less under the tutelage of Mr. Schumacher.

Q. To whom you looked up as your superior and chief? A. That is right.

Q. From time to time after September—by the way, Mr. Hatton, what did Mr. Curry do in the office of 37 Wall Street when you were there, and particularly during the period 1942, 1943 and 1944?

A. He was managing head of the Western Pacific. He did not have anything to do with me.

Q. Was he the head of the office there?

A. He was."

Mr. Clark: Mr. Adams, will you please read the next two lines?

Mr. Adams: Oh, surely.

"He ran the office management?

A. Right.

Q. For the Western Pacific, is that right?

A. Right."

Page 728, your Honor, under Examination by Interveners' counsel: [949]

"Q. During the meetings that you attended,

after you went on the board, during the years I have called your attention to, did you take any part in the discussion of various problems that affected the corporation? A. I did not.

Q. At any time did you ever cast a dissenting vote with respect to any resolution that was offered?

A. I did not.

Q. Is it a fair statement, Mr. Hatton, to say that you simply followed the majority of the directors in any decision that they might reach?

A. That is correct.

Q. In other words, you did as you were told?

A. I was not told.

Q. You simply followed the majority?

A. I followed my own judgment as to the proper thing to do."

Now, turning to page 740, if counsel will permit me I will state Mr. Hatton testified that he never had anything to do with the Western Pacific Railroad Company, that he understood the plaintiff corporation was a holding company in its relation to the Western Pacific Railroad Company. I have nothing further from Mr. Hatton.

Mr. Phleger: I have about four sentences. Page 713. [950]

"Q. What position did you hold with the Denver and Rio Grande Railroad at that time?

A. Assistant secretary and assistant treasurer.

Q. Were there other representatives of that company in the office at 37 Wall Street during that period?

A. Yes, sir. I had one clerk.

Q. What was his name, please?

A. His name was John Wienken."

John Wienken's name appears on the chart there as a director of the plaintiff corporation.

Mr. Adams: At a subsequent time.

Mr. Phleger: Reading on page 714:

"Q. Is it a fair statement to say that your duties during that period at the office at 37 Wall Street was purely clerical? A. Yes.

Q. There were no management problems that you attended to? A. None whatever.

Q. And I take it that you had no discretion to exercise on policy or things of that sort?

A. That is correct.

Q. What salary were you receiving from the Denver and Rio Grande during the period that I directed your [951] attention to, that is, 1942, 1943 and 1944? A. $4500 a year."

And on page 723: The questions before had to do with an attempt to fix the date when he became a director. The questioning then proceeds:

"Q. Does that refresh your recollection as to the date on which you became a director of the corporation? A. Yes.

Q. Does that accord with your memory?

A. No, I had 1943 in mind.

Q. With regard to the particular incident or occasion when you were invited to become a member of the board of directors of the Western Pacific Railroad Company? A. No, I do not.

Q. No memory on it at all?

A. Just a general hazy memory that they required another board member to bring it up to the legal requirements of the board."

That is all.

Mr. Adams: Your Honor, I will read from the deposition of Katherine C. Sheehan, which appears at page 751 and following, and will state again that this examination, taken on behalf of the interveners in this action, was taken at about the same time as the taking of the deposition of Mr. Hatton. [852]

Mr. Clark: The same day, wasn't it?

Mr. Adams: I think it was; that is right. It shows that Mrs. Sheehan at the time of the taking of her deposition was employed as a bookkeeper by a firm of lawyers in New York having no relation to this litigation, that she was employed in 1942, 1943, 1944 and up to about May 1, 1945, in the office of Mr. Schumacher, trustee for the Western Pacific Railroad Company.

Mr. Clark: The next question and answer does show, Mr. Adams, does it not, that she had been employed in the office since 1932?

Mr. Adams: That is right, yes.

During the period with respect to which she was testifying, specifically during the period 1942 and so on, to May 1, 1945, she was receptionist. She also helped on stock transfer work when the corporation took over that work. Everybody in the office worked on that. Her immediate superior in the office on that work was Mr. Curry. I do not recall where her salary is stated, but I think that

is in evidence now. In any event, if counsel desire the figure, if they will advise me we will put it in. I think it was about $2000 a year, something like that.

Mr. Clark: That is my recollection. It is on page 757: approximately $2000 a year.

Mr. Phleger: It is on the chart. [953]

Mr. Adams: Now, page 758, your Honor:

"Q. Do you remember, Mrs. Sheehan, when you became a director of the corporation?

A. Yes, February, 1944.

Q. The record in this case shows it was February 15, 1944. A. That would be right.

Q. Do you remember the particular incident or occasion when you were invited to become one of the directors of the corporation?

A. Yes, I was asked to become a director to fill the board to effect a quorum.

Q. By whom were you asked?

A. By Mr. Curry."

Mr. Phleger: Would you read the next two lines?

Mr. Adams: Yes, surely.

"Q. Was that while a meeting was in progress?

A. While a meeting was in progress, yes; I was invited in before I was appointed."

And further down on the same page:

"Q. Am I correct in stating that a gathering of the board had taken place in the board room prior to the time you went in there? A. Yes."

Mr. Phleger: And the next three lines? [954]

Mr. Adams: Very Good.

"Q. And thereupon you were invited in and asked to be a director, is that right?

"A. That's right."

And a question at page 771—no, wait; there is one other first. In the examination by the interveners' counsel, page 763, beginning at the bottom of page 762:

"Q. During that period that you were a director of this corporation—that is, the Western Pacific Railroad Corporation—Mrs. Sheehan, did you take part in the discussions of any problems that were posed to the board having to do with the corporation?

"A. No, I attended the meetings.

"Q. Did you take part in the discussions?

"A. No.

"Q. Did you ever cast a negative vote or a dissenting vote on any resolution that was offered on any proposition?

"A. No, I don't believe so. I usually went with the majority.

"Q. You simply followed the majority decision on whatever matter was before the board?

"A. That is right.

"Q. Did you know during that time who the tax counsel [955] for the corporation was?

"A. No."

Mr. Clark: Well, Mr. Adams, will you develop the rest of that subject so that it will all be before us? The next question and answer.

Mr. Adams: Yes, I will read it if you want. I hadn't intended to read it, though.

Mr. Clark: Well, it finishes that up, if I may suggest it.

Mr. Adams: Very well.

"Q. Let me mention the name of James K. Polk or Whitman, Ransom, Coulson & Goetz; does that strike any chord of recollection with you as to who represented the corporation in tax matters?

"A. Well, yes, I knew Whitman, Ransom, Coulson & Goetz.

"Q. Were the tax counsel?

"A. I knew they were the attorneys; I did not know they were the tax counsel.

"Q. Attorneys for whom, please? Your understanding at that time?

"A. Attorneys for the company, I believe.

"Q. The company or the corporation?

"A. I am a little confused at this point.

"Q. Take your time. The only thing we want is your best recollection and your actual understanding of [956] the position that you occupied at that time. Did you know or did you have an idea as to who Whitman, Ransom, Coulson & Goetz represented, as between the Western Pacific Railroad Company and the Western Pacific Railroad Corporation?"

Your Honor will appreciate that I am reading this at the request of opposing counsel.

Mr. Clark: That is correct.

Mr. MacKinnon: I think he should keep on reading.

Mr. Adams (continuing reading):

"A. I really do not know definitely.

"Q. Did you know Mr. Nicodemus at that time?

"A. Yes.

"Q. And you saw him at board meetings, I guess? "A. That is right.

"Q. What did you understand Mr. Nicodemus' position to be, if any?

"A. He was the attorney for the corporation.

"Q. He was the attorney for the corporation?

"A. Yes.

"Q. During those meetings of the board of directors of the corporation, while you were on the board, and those you attended, did you hear any statements or representations to the directors that the tax matters were being handled by Mr. Polk or Whitman, Ransom, [957] Coulson & Goetz?

"A. Yes, now I believe I did hear Mr. Polk's name mentioned in such regard."

The Court: I think I had better take a recess now. I have a criminal matter to hear.

(Recess.)

Mr. Adams: Your Honor, I was reading from the deposition of Mrs. Sheehan. Page 769:

"Q. Mrs. Sheehan, have you ever met Mr. Coulson? "A. Yes, I have.

"Q. Do you recall when that was?

"A. Well, I do not recall the exact time, but he was a director on the corporation board at one time, and he came into the office quite often.

"Q. It is true, is it not, that Mr. Coulson was

never a director of the corporation at the time you were a director?

"A. No, he was not a director?"

Then at page 770:

"Q. Did Mr. Coulson ever tell you how you should vote as a director?

A. No.

Q. Or give you any instructions as to how you should act as a director?

A. No, he did not. [958]

Q. Did you ever meet Mr. James K. Polk?

A. I never met him."

Then at page 771:

"Q. I will ask you this general question: Did anyone ever tell you how you should vote; that is to say, give you instructions about it?

A. No."

I have nothing further from Mr. Sheehan's deposition.

Mr. Clark: We have just one question and answer, your Honor, at page 768. May the record show that the last portion of the deposition read by Mr. Adams was in response to questions put by him?

Mr. Adams: That is correct.

Mr. Clark: And page 768, a question by Mr. Clark:

"Q. Did you exercise any independent judgment on any of these matters which were discussed during this period?

A. I do not think there was any occasion to."

Mr. Adams: Now, if your Honor please, I should like to read from the deposition of the intervener, Henry Offerman; and turning to page 4705 of Mr. Offerman's deposition, being at the beginning of his deposition, which was commenced April 26, 1948—Mr. Offerman having been called as a witness in behalf of the defendant railroad company and as an adverse witness. Now, I will attempt to state the material here in order to save the Court's time.

Mr. Offerman is one of the interveners, he is 53 years of age, attended the Lawrenceville school at Lawrenceville, New Jersey, from which he graduated in 1914. He then went to Yale until the first war and returned after the war. He was in the class of 1918, honoris causa, and then returned and graduated in 1919.

Some years prior to the taking of his deposition, he took a course in the New York Institute in railroads. He thinks that was about 1945 or '44.

At the bottom of page 4706, Mr. Offerman said that he is a customer's broker, employed by Goodbody & Company, and has been engaged in that occupation since 1940. A customer's broker has detailed handling of accounts. Some people call them "account executives."

And then there is a question on page 4707.

"Q. What are the functions and duties of a customer's broker, Mr. Offerman?

A. To consult with clients regarding their investments, to suggest various investments, changes

in their portfolio, to handle the detail of their transactions, give them any financial information that they ask for."

Prior to 1940 he was in the same business but in a different capacity. He was the manager of the bond department of [960] Babcock, Rushton & Company, which in January, 1940, merged with Goodbody & Company. Both of these firms are engaged in business in New York, or rather Babcock, Rushton was until the merger.

Page 4709:

"Q. Have you had business relations with Russell M. Van Kirk, one of the other interveners in this lawsuit? A. Yes, sir.

Q. Please describe what those business relations were.

A. I acted as broker for him mainly on securities listed on the New York stock exchange and curb, sometimes Chicago.

Q. Over what period of time did you have such business relations with Mr. Van Kirk?

A. From about 1935 until the date of his death.

Q. Which was quite recently, in this year?

A. In December, 1947."

I stop to say that Mr. Van Kirk's deposition was not taken in this action for the reason that he was ill at the time and then died.

"Q. Have you had business relations with Farlee & Company? A. Yes, sir. [961]

Q. What were those relations?

A. The same as with Mr. Van Kirk.

Q. Over the same period of time? A. Yes.

Q. Do they continue up to the present time?

A. Yes, sir."

At this time, your Honor, I will offer as Defendants' Exhibit 17 a schedule identified as Railroad Company Defendants' 770, entitled "Schedule of Preferred Stock of Western Pacific Railroad Corporation Owned as of April 1, 1948, Showing the Dates of Purchase and Costs of each Certificate."

The Court: "Company," did you say?

Mr. Adams: Preferred stock of the Western Pacific Railroad Corporation.

Mr. Phleger: If it please your Honor——

Mr. Adams: May I complete my offer?

Mr. Clark: To whom does that schedule pertain, may I ask, your Honor?

Mr. Adams: Henry Offerman. That is 770.

Then I offer as Defendants' Exhibit 18 a schedule identified as Railroad Company Defendants' Exhibit 787, entitled "Henry Offerman, Summary Schedule of all Purchases and Sales of Western Pacific Railroad Corporation Preferred Stock."

The Clerk: Mr. Adams, the last exhibit in evidence was 16. [962]

Mr. Adams: This is offered as 17.

The Clerk: And the last one you referred to is 18.

Mr. Adams: And I offer as Defendants' 19 a schedule entitled "Cleta C. Offerman, Schedule of All Purchases and Sales of Western Pacific Railroad Corporation Preferred Stock," each of these

schedules having been produced at our request by interveners.

Mr. Phleger: May I record our objection? This evidence has absolutely nothing to do with the merits of this case. It is incompetent, irrelevant and immaterial. We might just as well go on and make proof of the fact that the preferred stockholders in the plaintiff corporation invested more than $35,000,000 in their stock. In fact, the record shows that. But I take it that is not the matter we are trying here. To say that these interveners, who own a very small portion of the stock, paid so much for it is utterly incompetent, irrelevant and immaterial as to the issues of this case. I say the stock of this company, for which millions and millions and millions of dollars were paid, is represented by this corporation, which is the plaintiff.

Mr. Levy: Your Honor, just to record the position of the interveners on this, I wholeheartedly agree with Mr. Phleger, but the information was requested, we furnished it, and if your Honor thinks it is of any materiality, it is here. But I do not think it is either, and while we do not record an objection, [963] because we do not want to be in the position of appearing to keep from this Court any facts, we nonetheless concur in Mr. Phleger's position.

Mr. MacKinnon: Let me state our position with respect to this material. This is an equitable action. The interveners are in the action. This relates to the interveners' cause of action. Its

purpose is directed to that complaint. There is a motion before your Honor which you reserved decision on, and in connection with that motion, if nothing else, which will be renewed at the proper time, this material in my opinion has a very relevant and material bearing.

Mr. Adams: May I add a word, your Honor, to what has just been said by Mr. MacKinnon? This material was not furnished until there had been an argument presented before a Federal judge in New York and it was refused.

Mr. Levy: That is not true, Mr. Adams. I do not like to say that to you, but it is a fact, and I wish you would withdraw your statement.

Mr. Adams: Let me be sure about this.

Mr. MacKinnon: I think you are mistaken, Mr. Adams.

Mr. Adams: Very well, I am wholly mistaken. I should not have made the statement. I was entirely in error about that. I have a recollection of an argument, but I thought it pertained to this material.

Your Honor, one further statement in addition to what Mr. [964] MacKinnon has said: We rely, among other things, upon the authority of a decision of the United States Supreme Court in what I have referred to heretofore as the Comstock case, decided last year by the United States Supreme Court, and in a decision written by Mr. Justice Jackson. Mr. Justice Jackson stated that the appellant Comstock came into that proceeding at low

prices for the particular securities he held, and after an investigation he had made, going to show that here was a speculative possibility, that he was a speculator in that litigation, that he himself had no equities whatever, and I suggest that if the United States Supreme Court sees fit to make those statements in regard to a matter quite similar to this one—that was a proceeding in reorganization—the evidence we are offering is material and relevant.

The Court: I think I remember reading that case, but I do not carry it in my mind. It was some right of an intervener that was being asserted?

Mr. Adams: Yes, your Honor. Comstock was an intervener in that proceeding.

Mr. Levy: They were bondholders in a reorganization.

The Court: Some equitable right was asserted by them with respect to their position with the company, and the fact that the interveners had acquired the stock with the idea in mind that maybe they could litigate the matter and get something out of it was taken into account by the Court as an equity in [965] the case.

Mr. Adams: That is right, your Honor.

Mr. Levy: That was not a stock case at all. It was a bondholder's case, where the bondholder purchased the bonds after a certain plan had been promulgated and approved by the Court, and then he fought the question of the plan up to the Supreme Court.

The Court: I understand the point. What difference does it make in this particular case?

Mr. Adams: It goes to the equities of the interveners' case.

The Court: If the Western Pacific Railroad Corporation and its stockholders are entitled to some relief in the case, would the Court deny it because these men, as they sometimes do, go in on these shoestrings in the hope that something may come from it? Would that decrease the right of the plaintiff in the case?

Mr. Adams: Your Honor, we are entitled to show this as an equity, and involved in the equity is the question of the laches of these stockholders, the parties who bring this case before your Honor. There are no other stockholders here. The plaintiff is bringing the suit itself. This does not go to the plaintiff's case. It goes to the stockholders' case, the stockholders saying they bring something to your Honor that the plaintiff does not have.

The Court: Equity does not punish anyone. If the stockholders of the plaintiff corporation are entitled to relief in this case, would it make any difference that the interveners were speculators who appeared on the scene and stirred this thing up?

Mr. Levy: Not the slightest.

Mr. Adams: Your Honor's queries as to whether this has anything to do with this lawsuit I should like to respond to. This lawsuit is a lawsuit originated by these stockholders who were speculators,

and one of the questions involved in the lawsuit is the defenses that we bring forth, and our defenses include not only the statute but laches and bar of the reorganization. These stockholders, we think we are entitled to show, had not only full opportunity of knowledge but busied themselves about this and had no equity. They could have come into the reorganization court and brought this case to the court. They were subject to no domination or control. The court was open.

The Court: Is it your theory that the plaintiffs could prevail in this case and the interveners could not?

Mr. Adams: I think that is a fair statement, yes.

The Court: In other words, equity should say that the plaintiff should prevail because they have a right, but the interveners being speculators who started the thing should, let us say, suffer the burden or punishment of not being able to recover as stockholders a share of the corporation's [967] recovery?

Mr. MacKinnon: That is stating it very differently from what your question posed.

The Court: Perhaps so. I find sometimes if I put these questions sort of crudely, I get more response from the lawyers.

Mr. MacKinnon: The question as was posed, the answer is definitely yes; the interveners stand or fall on their own bottom. The plaintiff stands or falls on its own bottom. Whatever equities are against the interveners are against them.

The Court: There could be a different defense, then, to the interveners than to the plaintiffs?

Mr. MacKinnon: Definitely.

Mr. Phleger: May I state for just one moment? The Comstock case has been mentioned here, and about the only real application the Comstock case has here is that Mr. Justice Jackson said it did not make a bit of difference how the interveners or the plaintiffs in that proceeding got their stock; the matter would be considered by the District Court on its merits, because the right was the right of all people who were similarly circumstanced, the very point we are talking about. The intervention was allowed here in order that a cause of action belonging to the corporation might be asserted. The interveners have no separate cause of action. All they do here can aid the plaintiff. The plaintiff is entitled to any cause of [968] action exposed by the facts. But what they paid for their stock is utterly immaterial. The idea that the plaintiff's right could be destroyed by an equity running against people who held only a small number of shares shocks the conscience.

Mr. Adams: It did not shock Mr. Justice Jackson's conscience.

Mr. Phleger: I suggest that you read that case to the Court:

Mr. Adams: Yes, I would be very happy to do so.

Mr. Levy: Your Honor will find in this very district, in the case of Blum v. Fleishhacker, de-

cided by Judge St. Sure, the Judge made an express finding that the motives of this particular plaintiff who brought a derivative action had not the slightest thing to do with whether or not the corporation on whose behalf he was suing had or did not have a right of recovery, and he so decided the case.

Your Honor will find that in the famous Penn-road case, which we have cited in our brief and I think Mr. Phleger has cited it also, the Court made the same conclusion. And your Honor will find that the Circuit Court of Appeals for the First Circuit has expressly stated, and Judge St. Sure relied on it, that when you have a derivative right asserted by shareholders, if the corporation has the right, they may assert it.

I just want to point out one thing to your Honor. Mr. Adams examined Mr. Offerman on deposition for two weeks. [969]

Mr. Adams: There is nothing surprising about that. These depositions in many cases lasted a long time.

Mr. Levy: Mr. Adams, may I continue uninterruptedly? The examination went on for two weeks and was directed to show the motives, whatever Mr. Adams conceived them to be, of Mr. Offerman in launching this lawsuit, and your Honor will find that in an effort to show Mr. Offerman's motives he went into matters that were completely unrelated to this tax transaction, because this tax transaction did not occur, your Honor will recall, until

July 15, 1944, and Mr. Offerman became a stockholder of this corporation for the first time in June of 1942. Now, it is a fine-spun theory that had no legal basis, it has no factual basis, and I think you will find that it will serve only to clutter this record with something that has nothing to do with the fundamental question, and that is whether or not this corporation, because of the relationship between it and the defendant during the critical period, had a claim which is now properly being asserted. If your Honor wants to try the issues, I think they will contribute nothing to the end result of who is entitled to win this case.

Mr. Adams: I can read what I am going to read out of Mr. Offerman's deposition in an hour, if I read without interruption. I am not going to impose on your Honor at any great length.

Mr. Clark: The objection was directed to the exhibits. [970] Mr. Phleger made the objection; we did not. We are simply stating our position.

Mr. Adams: I take it you make no objection?

Mr. Clark: I think the record will show we made no objection.

Mr. Levy: It was so stated, though I concurred with Mr. Phleger's position.

Mr. Clark: Your Honor must find on the basis of decisions in this district and elsewhere in the end that the amount of stock, the price paid for it, and the so-called motive is immaterial, and factually the Offerman situation does not square up with Mr. Adams' contention, but if your Honor wants it in the record we do not care.

Mr. Levy: I do not want it understood by not making objections that your Honor will permit Mr. Adams to go on as he did in the depositions.

The Court: Are you going to read other testimony which you say will take some time from this deposition on the same subject matter as referred to in the exhibits?

Mr. Adams: No, your Honor. I am going to read some testimony, but it won't be very long. It is in Mr. Offerman's deposition. It is not testimony about prices or purchases that are shown in these exhibits.

Mr. Levy: It bears on the same subject, doesn't it, Mr. Adams, namely, your defenses? [971]

Mr. Adams: Certainly it bears on our defenses or we would not offer it.

The Court: I will reserve ruling on these exhibits until I hear what you are going to read from the deposition.

(The schedules referred to were marked Defendants' Exhibits 17, 18 and 19 for Identification.)

Mr. Adams: Now, if counsel will turn to the top of page 4736——

The Court: Do you happen to have the citation of that Comstock case?

Mr. Adams: I haven't it here, but I will get it.

Mr. Phleger: I have it.

Mr. Levy: Would your Honor like to have the citations of the cases I mentioned as well?

The Court: The Comstock case?

Mr. Levy: No, but the three cases I referred to.

The Court: Before we adjourn for lunch you may give them to the clerk.

Mr. Phleger: I have the Comstock citation, your Honor: 335 U.S. 271.

Mr. Levy: Here are the three cases to which I referred: 21 Fed. Supp. 527, which is the Blum v. Fleischhacker in the District Court here; Johnson v. King-Richardson, 36 Fed. (2d) 675, page 677, relied on by Judge St. Sure—that is the Circuit Court for the First Circuit—the Pennroad case, [972] which is 42 Fed. Supp. 586, at page 625, which is the finding and conclusion of law, a Delaware case, since this is a Delaware corporation and the rights of the stockholders derive by Delaware law, Echleman v. Keenan, 181 Atlantic 657.

Mr. Adams: At page 4743, being the last question on that page:

"Q. At the time you made this first purchase, what did you learn about the status of the various subsidiaries of the Western Pacific Railroad Corporation?

A. Well, my recollection is that after much investigation, that the whole matter was quite confused as to the exact status of the subsidiaries, the loans that had been made and the pledging of the various stocks, were a question of some doubt whether there had been a capital contribution there or just how they stood.

Q. What was the question as to the capital contribution that you learned about in July, 1942?

A. By the loaning of the money to the Western Pacific Railroad Company without security, inasmuch as they had the same officers and directors.

Q. Did you learn at that time that they had the same officers and directors? A. Yes, sir."

Now, I read the preliminary questions solely for the [973] purpose of leading up to the last question the witness learned "that they had the same officers and directors."

Mr. Levy: By preliminary questions, do you refer to the first and second?

Mr. Adams: Yes, the first and second, and I can only get to the third one by reading the first two.

Mr. Levy: And that was the purpose of your reading?

Mr. Adams: That was the sole purpose of my reading. Page 4747:

"Q. Did you inform yourself and learn prior to the time you made your first purchase that there were interlocking directors and officers?

A. I gained such information from the reports, yes, sir.

Q. And that was one of the factors that you had in mind at the time you purchased the stock?

A. Yes, sir." [974]

Mr. Adams: Page 4853. Question at the bottom of that page: "Q. Do you have any recollection that the railroad company's reports for 1942, 1943 and 1944, or any of them, were among papers that you removed from your files and destroyed?"

"A. No, sir.

"Q. Do you have any recollection one way or the other on that subject?

"A. I know that they were not removed from the file, if they were ever in there.

"Q. Have you any recollections to whether or not they were ever in there?

"A. If they are not in there now, they never were in there, because I may have used Goodbody's file, and those copies would be returned for their files. This was my own personal file, in which I had extra copies. I used the combination of the two, and after a while, I ceased collecting a lot of things in my own file and just used what was available in Goodbody's. I didn't see any use in having two reports."

Page 5002:

"Q. Did you know Mr. Thomas M. Schumacher and Mr. Sidney M. Ehrman were the trustees in reorganization of the Western Pacific Railroad Company during the period 1935 to the end of 1944, and were discharged as such in May [975] of 1945?

"A. Yes, sir."

Then the witness supplemented the answer, saying, "My knowledge does not concern the dates."

"Q. What was the source of your information as to the fact that Mr. Schumacher and Mr. Ehrman were trustees in reorganization of the Western Pacific Railroad Company?

"A. The annual reports."

Page 5128:

"Q. Mr. Offerman, how long had you known Mr. Russell Van Kirk?

"A. About twenty years.

"Q. Were you near neighbors for several years prior to the death of Mr. Van Kirk in 1947?

"A. Yes, sir.

"Q. Were you and Mr. Van Kirk engaged in the same business in New York during the period of your acquaintance with him?

"A. A similar business.

"Q. Did you act as brokers for each other in connection with securities transactions over the period of years that you knew him? "A. Yes.

"Q. Did you frequently discuss matters of common interest [976] with Mr. Van Kirk?

"A. Yes, sir.

"Q. Would you say that you have known Mr. Van Kirk closely and intimately?

"A. Yes, sir.

"Q. What was the relation of Mr. Van Kirk to J. S. Farlee & Company?

"A. I believe he was the chief stockholder."

Your Honor will bear in mind J. S. Farlee & Company is the other intervener in this case. Page 5137:

"Q. Did Mr. Van Kirk at any subsequent time tell you that he had made any further investigation or inquiry into the Western Pacific?

"A. Yes, sir.

"Q. When was that subsequent occasion?

"A. Early in 1946.

"Q. What did Mr. Van Kirk tell you at that time

about investigations or inquiries made by him?

"A. He had looked into the matter of the filing of consolidated tax returns. He had seen a clipping in a newspaper about Consolidated Electric & Gas, I think it was. I saw the same thing and we discussed it. We discussed the consolidated tax returns.

"Q. Referring to that time early in 1946, was the substance of what Mr. Van Kirk told you as regards any [977] inquiry or investigation at that time that he had seen some newspaper clippings about Consolidated Electric & Gas that related to consolidated tax matters? A. Yes, sir.

"Q. Did he tell you at that time that he had made any other inquiry or investigation in regard to the Western Pacific? A. Yes, sir.

"Q. What did he tell you in that regard?

"A. That he had looked into the matter carefully, talked it over with attorneys, and thought that the same principle as referred to in the clipping would apply to the Western Pacific.

"Q. Did you understand from what Mr. Van Kirk told you that his interest in this particular subject was aroused by reading the newspaper releases on the Consolidated Electric & Gas?

"A. Yes, sir."

Page 5192:

"Q. Mr. Offerman, have you made any commitment or agreement with anyone that in any way limits your privilege or right to buy or sell Western Pacific preferred?"

Mr. Levy: Now I object to that, your Honor. I can't see the slightest materiality to that. I object because it is part of this effort of Mr. Adams to inject completely immaterial [978] matters into this case.

The Court: Have you made any agreement with anyone for what?

Mr. Adams: Limiting his privilege or right to buy or sell stock.

The Court: Limiting whose privilege?

Mr. Adams: Mr. Offerman's personal privilege or right.

The Court: What does he answer it, "no"?

Mr. Adams: Yes.

The Court: Go ahead.

"Q. (By Mr. Adams): You are entirely free to buy or sell Western Pacific preferred at any time? A. Yes, sir."

Page 5194:

"Q. Mr. Offerman, during the year 1943, did you as broker or customer's man purchase or sell preferred stock of the Western Pacific Railroad Corporation for the account of your clients or customers?

"A. It is my recollection that some customers bought and sold the stock."

Then going toward the bottom of that page:

"Q. And subsequent to 1943, have you continued as broker or customer's man to buy and sell stock for the account of your customers or clients?

"A. Yes, sir."

Page 5200: [979]

Well, it is noon hour, your Honor, and I seem to have missed a spot. If it is convenient to your Honor to take the recess now?

The Court: Well, we will reconvene today at 2:15. I have this criminal matter at 2:00 o'clock. We might as well take the extra time.

Do you consider that, from the equitable point of view, Mr. MacKinnon, there is anything essentially wrong in a person's buying on speculation stock in a corporation with the hope of perhaps thereafter increasing the value of the stock by instituting or causing the instituting of litigation?

Mr. MacKinnon: I certainly do.

The Court: That is the essential, equitable point that you are urging?

Mr. MacKinnon: That is only one of the points.

The Court: That is one of the points?

Mr. MacKinnon: Yes.

The Court: Now is that the subject matter of the discussion in these cases?

Mr. MacKinnon: No, I don't think so.

Mr. Adams: I think it is referred to in the Comstock case.

Mr. MacKinnon: Yes, in the Comstock case. It is not dealt with only in the sense of that question, though.

Mr. Levy: It is referred to in the cases I supplied to you, your Honor. Your Honor is mindful of the fact that Rule [980] 23 provides that you must be a stockholder at the time of the wrong in order to bring the action, and the situation is thus

encompassed in the Federal Rule, all of what was previously urged as efforts to buy stock in order to bring litigation. Now if you comply with that rule, as I understand the cases, you have done what you are supposed to do to be properly in the Federal Court; and I think that constitutes the complete answer to Mr. MacKinnon's question as well.

Mr. MacKinnon: I am not saying they have a right to do whatever they have a mind to with this stock, but they are coming into this court and asking this court to exercise equitable principles in their favor, and I say in the exercise of those equitable principles, your Honor has to see the facts and weigh their purposes and their motives and the price they paid, their activities in creating a market.

The Court: Only if there is some equitable disability.

Mr. MacKinnon: That is right. This is such a case. This is an equity case. Nobody can point to any law on this subject.

The Court: But granted it is an equity case; do you have to have an equitable disability on the part of the plaintiff, recognized by law?

Mr. MacKinnon: That is right.

The Court: Before you can——

Mr. MacKinnon: No, I wouldn't say that at all—not recognized by law. [981]

The Court: I think that is where we sometimes make mistakes in decisions, where we reach out into the air and pull in something which we think ought to be the way to do things.

Mr. MacKinnon: But that, your Honor, is the very thing you are asked to do in this case, because they cannot point to any law in this case. There is no precedent for this case.

The Court: Well, that still doesn't mean——

Mr. MacKinnon: That means that you, as a chancellor, will have to determine on the basis of all the equities whether you believe there was over-reaching. You are not going to find your basis in stare decisis or anything of the kind. You are asked as the chancellor to determine whether or not you should involve equitable principles under the circumstances here present.

The Court: Well, I don't see that that thing is the precise issue that we have now, as to whether or not there is any equitable disability on the part of the interveners.

Mr. Levy: Your Honor, may I say one more word on the point?

The Court: In other words, if the stockholder is entitled to bring the action, it wouldn't make any difference how many shares of stock he traded in.

Mr. MacKinnon: His motive in an equitable case is certainly, in my opinion, of the most material importance.

The Court: Well, let's suppose that I owned 5000 shares of the corporation's stock, and had owned it for ten years before 1934. [982]

Mr. MacKinnon: I would say there, your Honor, there would be no question.

The Court: Well, this man owned some stock in '42, didn't he?

Mr. Adams: Yes, he bought it on a spec after he looked into the matter of the disabilities possibly arising from interlocking directors.

Mr. Levy: It has nothing to do with taxes.

The Court: Don't all your clients buy stock in corporations on speculation?

Mr. Adams: Not only after investigating the importance of, or the possibility of, having a lawsuit and investigating whether there would be any disability arising from interlocking directors.

The Court: Well, there are lots of reasons people buy stock. They buy stock because they think the corporation is a losing proposition; I think I have heard of people doing that. So they could take stock losses. I don't think that that has anything to do with this.

Mr. MacKinnon: No, I don't think that has. I don't care whether, as a matter of fact, they want to invest this money in stocks and bonds—that is their business and that is perfectly o.k. But this is a market operation, in my opinion. When the schedules indicate that their stock, by reason of their market operations, cost them about 37c a share, or nothing—it is all concentrated into a very limited period. Now I do think that is [83] an equitable factor of considerable importance for your Honor's weighing.

The Court: Well, of course, wouldn't that affect the right of any stockholder then, who owned stock in the company, as to whether he traded it during the times that are involved here?

Mr. MacKinnon: No, I wouldn't say so at all. I would say if a person went out and bought stock in this period of time and was a holder of that stock, your Honor would approach the equities in that situation very differently than a man who was in a position of a customer's broker, going out and stirring and creating interest in the stock for the very purpose of raising the price of the stock.

Mr. Clark: Are you testifying, Mr. MacKinnon?

Mr. MacKinnon: I am making an argument to the court, and that is the purpose that the court addressed his question to me, and that is where my argument will be addressed at all times.

Mr. Levy: Will Mr. MacKinnon state to the Court that the evidence justifies that assertion?

Mr. MacKinnon: I believe it does.

Mr. Adams: So do I.

Mr. Levy: Your Honor will be mindful of the wild charges. I think there is absolutely nothing in the record to justify it, apart from any legal argument of relevancy.

Now just hypothesize that instead of this plaintiff corporation having determined after we brought the New York action that [984] action should be brought; hypothesize that they didn't do that and that these stockholders, instead of being interveners, were the plaintiffs before this court, suing on the same situation; just assume that we proved the same case that has been proved here, and let's assume, to carry it one step farther and pose the question at the North Pole, that your Honor con-

cluded that this corporation was 1000% entitled to the recovery which the intervener said it ought to get. Then Mr. MacKinnon would come to you and say that because they are in Wall Street, that that name, and because they have bought some stock, that therefore the corporation couldn't get any of these tax savings, and Mr. Adams' clients should not do otherwise than nobly be left with a windfall.

Now that is what that argument comes to.

The Court: Well, I don't understand that Mr. MacKinnon has made the argument that anything that the interveners have done prejudices the plaintiffs.

Mr. MacKinnon: No, I did not.

The Court: He has some theory that the interveners——

Mr. MacKinnon: They stand on their own body.

The Court: He has some theory that the interveners are going to be under some disability with respect to this case; that is the point as I understand it.

Mr. MacKinnon: That is right.

Mr. Levy: That is the point, but I only want to emphasize [985] the nature of the point by pointing out to you that if the interveners were here on behalf of the plaintiff, without the plaintiff corporation, for instance, as they are in New York, if Mr. MacKinnon's argument is sound, then the action would be defeated for these reasons. I don't want your Honor to think——

The Court: Well, I understand.

Mr. Levy: I want to focus it that way. I think——

The Court: Counsel, I think the heavier burden to sustain is on your side of this precise question.

Mr. MacKinnon: To show the disability? Yes. Well, that is the burden we took on. That is what we are trying to do. That is the purpose of these schedules.

The Court: Well, I am trying to find out what the logical reason is for the rule which you contend should apply.

Mr. Adams: Your Honor, may I address myself to the court as to that question? The plaintiff comes to court, and there are certain defenses raised against the plaintiff. Now those are good or bad, as against the plaintiff; and an issue lies between the plaintiff and the defendant. There are the affirmative defenses—the bar, laches, time of various sorts, estoppals. Now then, maybe those defenses are good, but the interveners come in and they say to your Honor, "Well, your Honor, those defenses aren't good defenses against us. They are not good defenses against the stockholders," because of some of these things they point to. Some of these assertions they make, that there is [986] duality, domination, control and that sort of thing. They say they are in a position to obtain a judgment for this plaintiff, that the plaintiff itself, perhaps, is prevented from getting; for the reason that those defenses don't run against them. They say we hadn't notice. Those contentions, as I understand it, have been in this case.

The Court: I don't understand that to be Mr. MacKinnon's point.

Mr. Adams: No, I don't think so either, but I am presenting that suggestion to your Honor.

The Court: I can't see much merit in that. I am just wondering whether or not there is anything that would mean that equity is such, shall I say, that even though a meritorious cause of action be developed and sustained, that equity would be so heartless as to say that the fellow who brought it about, no matter how much he may have been a speculator for his own benefit, that that is going to shut him out from the recovery, if there were one made. It seems to me that is kind of a cold blooded doctrine, and I am just trying to find out your position.

Mr. MacKinnon: I think equity is a cold blooded doctrine under certain circumstances.

Mr. Levy: Not as I learned it in law school.

Mr. MacKinnon: Well, if you cite the maxims, you won't have much difficulty.

The Court: I think we had better let you gentlemen go to [987] lunch.

Mr. Phleger: I would simply like to point out that we filed this lawsuit, we made the evidence, and if that evidence shows that the plaintiff is entitled to recovery, it seems to me it is utterly and wholly immaterial what this intervener did, how he got his stock; or evidently we are trying to have a trial within a trial here. I don't see how the plaintiffs are affected in the slightest degrees by this issue.

Mr. Adams: Your Honor will bear in mind that the objection comes and is stated solely from this side of the house. There is no objection before your Honor from the interveners.

Mr. Levy: I just want to make that point, too, your Honor.

The Court: Well, perhaps Mr. Phleger is feeling in a generous mood today and wants to do something for the interveners, even though they have been shooting a few barbs at him once in a while.

Mr. Adams: I suggest that that may pertain to your Honor's consideration.

Mr. Levy: I want to say, because we have not made many objections because, as so often happens, when you generate this kind of a fuss there is some lingering thought that there is something in the position of the defendant. For that reason, we haven't made the objections, and the evidence can go in for some purpose and go so far, and then maybe we will fight about it. But I do think that in principle, Mr. Adams' position is wrong. [988] I think Mr. MacKinnon's position is wrong. I think it would be a mistake of law if your Honor ruled in favor of it.

Mr. MacKinnon: Your Honor understands that if we thought the plaintiffs and interveners were right, we wouldn't be having a lawsuit, so it is fairly obvious Mr. Levy thinks we are wrong.

The Court: Well, we will continue this afternoon.

(Thereupon a recess was taken until 2:00 p.m. this date.) [989]

Afternoon Session—2:00 P.M.

Mr. Adams: May I have the Offerman deposition, beginning at about page 5000? Page 5005:

"Q. Do you assert that either Mr Schumacher and Mr. Ehrman as trustees or either of them were party to a plan to deprive the corporation of any rights they felt they had in connection with the income tax returns for 1942, 1943 and 1944?

A. I do not understand the question, sir.

Mr. MacKinnon: Read it.

(Question read.)

Mr. Levy: Answer if you know, Mr. Offerman.

The Witness: No.

Q. (Still by me, your Honor): Do you assert that the board of directors of the railroad company during the period it was in reorganization—I am speaking of the board of the company—while the railroad company was in reorganization, do you assert that the board of directors had anything to do with the income tax returns for 1942, 1943 and 1944? A. No.

Q. Do you assert that the board of directors of the company, after it was reorganized, the present board of directors, was party to a plan to deprive the corporation of any rights which the board considered the corporation had in connection with the income tax returns for 1942, 1943 and 1944?

A. No.

Q. Do you assert that this board of directors, that is, the board of the present railroad company,

had any intent or purpose in the income tax matters to aid or favor the James interests?

A. No.

Page 5200:

"Q. In the advice you have given to your customers subsequent to June, 1946, what have you advised them was the relation between the litigation and the value of the Western Pacific preferred?"

Mr. Levy: Your Honor, what has that to do with this litigation? I object to that as being incompetent, irrelevant and immaterial.

Mr. Clark: Also it assumes something not in evidence.

The Court: Did he answer it and tell what important advice he gave?

Mr. Adams: Yes.

The Court: What is the relevancy of that?

Mr. Adams: It is directly relevant to the matter under discussion this morning, your Honor, Mr. Levy's contention [991] being that there was nothing in the way of the activities of these gentlemen, in the way of market transactions in relation to this lawsuit, and this answer is directly responsive to that question.

The Court: I think the objection is good. I will sustain it.

Mr. Adams: Page 5265: The question at the bottom of the page:

"Q. Do you have any authorization from any stockholders of the corporation to act in their behalf in this litigation?"

Mr. Levy: I want to object to that question as being utterly immaterial, incompetent and irrelevant, and having no importance in this litigation that I can see.

The Court: This is a representative suit, isn't it? I mean the intervention is a representative suit?

Mr. Clark: It is a question of law, your Honor.

Mr. Adams: This is a question of fact, your Honor, that I asked of the witness, not meaning to have any discussion about the law at all. I want to find out from him whether in fact he held any authorization from any other preferred stockholder.

The Court: I do not see the materiality of that. I will sustain the objection.

Mr. Adams (reading):

"Q. Had you solicited any such authorization from [992] the preferred stockholders of the corporation?"

Mr. Levy: Same objection, same grounds.

The Court: Same ruling.

Mr. Adams (reading):

"Q. What financial interest do you have in this litigation?"

This is on page 5266.

Mr. Levy: Same objection, same grounds. The evidence in the case shows what his financial interest is.

Mr. Adams: There has been an objection to that evidence.

Mr. Levy: The stock holdings of this witness have been put in by stipulation.

Mr. Adams: Oh, no, the fact that this particular witness has not a dollar invested now that he has profited on the transaction, those facts are not in evidence. They have been offered and his Honor has not ruled on them.

The Court: If it is necessary to determine this matter, I think I should be ready to rule on that now. I read the decision—I did not have an opportunity to study it—in the so-called Comstock case. I do not see that that has any bearing on this matter.

Mr. Adams: I shan't argue that, your Honor. I will only state that in the Comstock case the evidence was received, that each of the courts that dealt with the Comstock case in turn, the District Court, the Circuit Court of Appeals and [993] the Supreme Court considered and they commented upon that evidence.

The Court: In the Comstock case the man came along after the reorganization had been in progress ten years and then acquired some stock, and then sought to have the Court redetermine the claim of a creditor that had been filed a long time before that time, despite the fact that obviously that was a dilatory procedure in the course of the administration of the estate; the court nevertheless let the man be heard and still decided the matter whether the claim was proper on its merits and held that it was. It held that even though there was domination and control, that nevertheless the domination and control did not have the effect of accomplishing any

unconscionable or improper result on the merits of the case. But I cannot see how there can be any possible relevancy as long as the intervener, bringing an action in a representative capacity, satisfies the requirements of our procedural rules and was a stockholder prior to the time the cause of action arose. Anything else is immaterial, and the fact that this is a suit in equity should not result in the imposition of any sanctions by virtue of the activities of the intervener that haven't got anything to do with the cause of action. I do not think that there is any judge that has ever held that, and if there were, unless he were a higher judge, I would not be inclined to agree with him. I do not think that equity could [994] possibly act in such a harsh manner as that. There is just no point to it. The objects of the principles of equity are to do equity. And in the guise of and under the panoply of equitable rules, if you do just the reverse, you are certainly not doing equity in the matter. I think all this line of testimony is incompetent and I so hold, and I will sustain the objections to this.

Mr. Adams: May the exhibits be marked for identification?

The Court: They have already been marked for identification.

Mr. Adams: They have?

Mr. MacKinnon: As 17, 18 and 19.

The Court: That is right.

Mr. Adams: And I think, just to be sure I have a ruling on the question, I will ask the question once more, the last one I read:

"Q. What financial interest do you have in this litigation?"

to which I understand objection was made. Did your Honor sustain the objection?

The Court: Well, I don't know whether this question involves—I don't know just what you mean by the question. What financial interest the man has—I assume he had some, because he sued.

Mr. Clark: The stock reflects it, your Honor; whatever the stock reflects of his assets, the assets of the corporation. It has been conceded that Mr. Offerman holds 4000-odd shares [995] of the stock and has been a stockholder since early 1942. That is all there is to the matter.

Mr. Adams: I am just offering this for the record.

The Court: Well, have you in mind some other purpose? I am not ruling in the dark on the matter—is there some other field or purpose, some other field of investigation or purpose to the question?

Mr. Adams: The last question, your Honor, "What financial interest do you have in this litigation?" was asked to find out specifically what that financial interest is. There was no other purpose.

The Court: Well, I will sustain the objection.

Mr. Adams: Now, your Honor, at this time, with your Honor's permission, Mr. Matthew will put in a part of our defense relating to proceedings in the reorganization court.

The Court: Did you have any other matters that you wanted, either side, in connection with the deposition of Offerman?

Mr. Clark: No, sir.

Mr. Levy: May we reserve the right to read some part——

Mr. Clark: No, it is struck out.

Mr. Levy: It is struck out?

I didn't understand the Court's ruling that everything that has been read was struck out.

The Court: Well, everything that has to do with activities of the witness with reference to acquisition of stock [996] and matters of that kind. I don't recall—though there was some preliminary matter of whether he went to Yale and things of that sort which I don't think is important.

Mr. Clark: As I understand it, your Honor, everything developed along the line that we have been discussing and with respect to which the offer of certain documents was made is stricken from the record as the result of this ruling—or at least your Honor has indicated you don't intend to give any weight to it.

The Court: Well, Mr. Adams has read all of the questions and answers, and they are all in the record, and I think that with what is in the record and the ruling that the Court has made, you are protected.

Mr. Clark: I think so.

Mr. MacKinnon: Well, if your Honor is striking, will you so indicate, because I would like to have an exception?

The Court: You will not have to take an exception.

Mr. MacKinnon: I do have to take an ex-

ception to that; there is a specific motion, as I understand it, which is being brought in through the back door, on the question of all the testimony that has been adduced. There is no necessity of an exception with respect to the three or four objections that have been made and sustained. As I understand it now, the interveners take the position that your Honor is striking everything that is in the record. [997]

The Court: Well, I didn't mean that. I meant just everything to which this objection applies.

Mr. MacKinnon: The last objection?

The Court: The objection to which I referred in the ruling. [997-A]

Mr. Clark: Right. Well, may it please your Honor, so that we can get a motion to strike which meets all the technical requirements, may I reserve the right to make that after we get the record written up, and then I will mark the places which I think are consistent with your Honor's ruling, and make a formal motion to strike that in that fashion to satisfy Mr. MacKinnon?

The Court: Counsel's rights will be protected then.

Mr. MacKinnon: Any way they wish to do it.

Mr. Adams: Surely.

Mr. Matthew: May it please the Court, I ask leave to present certain documentary material from the record of the reorganization proceeding in this matter, and first I would like to offer certain excerpts from the commission's plan of reorganization.

The Court will recall that Mr. Phleger referred to the plan, deeming it unnecessary to offer it physically in the record, in which suggestion I fully concurred. He read briefly from the plan, and I desire to read briefly two or three excerpts. The Court will have in mind that in the preliminary memorandum of the defendant, the Western Pacific Railroad Company, we reproduced in the appendix certain excerpts from the commission's reorganization plan, and likewise certain excerpts from orders of the reorganization court. It might be convenient for the Court just to refer to that appendix in following some of my quotations. I have a copy here, if it is not readily available [998] to the Court.

The Court: Do you have another copy?

Mr. Matthew: Yes, I have.

(Handed to the Court through the Clerk.)

Mr. Matthew: First, I desire to read some of the text which appears upon page 3 of appendix A to the preliminary memorandum of defendant, the Western Pacific Railroad Company, to which I have just referred. It appears about in the middle of this printed pamphlet. I read first from the commission's plan or order certain definitions as follows:

"The debtor shall mean the Western Pacific Railroad Company.

"Consummation of the plan shall mean the transfer to the reorganized company to the extent con-

templated by the plan of the properties and assets of the debtor.

"The reorganized company shall mean the corporation whether the debtor or a new corporation which shall acquire substantially all of the properties now held by the bankruptcy trustees and issue the new securities provided for by the plan."

That ends the quotation. I think the pertinence of those definitions is obvious without the aid of comments. I now desire to read Subdivision Q of the plan, appearing on page 4 of Appendix A to this preliminary memorandum. I am now quoting:

"Claims against the debtor entitled to priority over any [999] mortgage of the debtor, current liabilities and obligations incurred by the trustees of the properties of the debtor during the reorganization proceeding, and expenses of reorganization allowed by the court within the maximum fixed by this commission, shall be paid in cash or assumed by the reorganized company, provided that any amounts so assumed by the reorganized company shall constitute a charge upon the properties of the reorganized company prior in lien to all new securities issued under the plan. When so treated, claims against the debtor entitled to priority over any of its mortgages are found not to be affected by the plan, obligations under the debtor's equipment trust certificates, the Baldwin lease, and the Pullman contract, are found not to be materially and adversely affected by the plan. The reorganized company shall be deemed to have assumed the executory contracts of the debtor, which by their terms do not

terminate at or prior to the conclusion of the reorganization proceeding, and which shall have been affirmed or shall not have been disaffirmed by the trustees of the properties of the debtor with the approval of the court prior to the confirmation of the plan, and also any executory contracts made by the trustees of the properties with the approval of the court, which by their terms do not terminate at or prior to the conclusion of the reorganization proceedings."

I now desire to read from Subdivision R of the plan, the text appearing upon page 5, appendix A, to which I have referred:

"The capital stock of the debtor and the unsecured claims against the debtor not entitled to priority over existing mortgages shall be cancelled."

After some text which is omitted and not deemed immediately pertinent, the quotation continues as follows:

"The plan may be carried out either by revesting the properties formerly of the debtor in the debtor company, or by transferring said properties to a new corporation organized for the purpose and the execution by the corporation in which said properties are vested of the new mortgages and the issue by it of the new securities contemplated by the plan."

That is all the text I desire to read, from the commission's plan at this juncture. I now desire to offer a copy of the court's order of August 2, 1935, in the reorganization proceeding, approving the petition for reorganization as properly filed.

I understand that under the stipulation, it is not necessary to actually introduce physically in the record copies of these orders, but I thought it might be convenient to court and to counsel if I do actually offer for the record a copy of that order No. 1, signed by Judge St. Sure on August 2, 1935. I would like to have it received and marked with the next succeeding [1001] exhibit number.

The Clerk: Exhibit 20.

(Order No. 1, signed by Judge St. Sure, of August 2, 1935, was thereupon received in evidence and marked Defendants' Exhibit 20.)

* * *

Mr. Matthew: There are certain provisions of this order No. 1 which I think should be drawn particularly to the attention of the Court, and without preliminary comment, I think that I will ask leave to read briefly from the order which has just been received in evidence as Defendant's Exhibit No. 20.

Paragraph 2 of the order on page 1 of this typewritten text confers the customary authority upon the debtor as to the operation and the maintenance of the property. I need not read the entire text, I think. I desire to read a portion of the text appearing in lines 29 to 31 toward the bottom of the page. I now quote:

"And to employ and discharge and fix the compensation of all officers, attorneys, managers, superintendents, agents and employees."

I think I should state to the court at this junc-

ture that it is that particular authority pursuant to which the firm of Pierce & Greer and Mr. Nicodemus was continued in the service of the trustees during the trusteeship, as has been shown in this proceeding.

The Court: Wasn't there another order made when the trustees were appointed?

Mr. Matthew: No, except this.

The Court: Or was this order incorporated?

Mr. Matthew: Yes, I was going to say, and I will come to that order a little later on, the later order of the court, which I shall shortly bring to your Honor's attention, confirms this particular authority and I make this explanation now for the reason that the court may have gained the impression that there was some specific order which authorized the continuance of the employment of Pierce & Greer, who had been counsel prior to the filing of the petition. It was this general authorization pursuant to which the firm of Pierce & Greer was continued in service and pursuant to which other counsel and attorneys were retained by the trustees from time to time.

I now turn to page 2 of the order, and again I shall not read the greater part of the text, which confers general authority of the conventional character upon the company, but I should like to read two sentences and particularly connecting at line 21 on page 2:

"The authority given by the foregoing shall not include authority to incur expense other than such

as is necessary in the course of the usual and ordinary maintenance and operation of the debtor's property. Any extraordinary [1003] expense and expense incident to reorganization of the debtor shall be subject to the prior approval of the court."

I now desire to read a portion of the text of paragraph 3 of the order commencing at line 27 on page 2:

"That the debtor is authorized in its discretion from time to time, and until further order of this court, out of funds now, hereafter, or hereafter coming into its hands, to pay (A) all taxes and assessments due or to become due upon the property of the debtor; (B) all necessary expenses of operating the railroads and conducting the business of the debtor, including among other expenses the wages, salaries, and compensation of all officers, attorneys, counsel, managers, superintendents, agents and employees retained by the debtor."

I think I need not read further at this juncture. I will just make the observation that this particular provision is in a sense correlated with or perhaps supplementary to the information given by the court to the company to perform as services, including the employment of counsel, and then complements that authority by authorizing the payment of the wages, salaries and other expenses thereby incurred. I think I need not read further at this time at least from this initial order, No. 1.

I now offer as Defendant's Exhibit No. 21 a copy of an order made by the reorganization court, by

Judge St. Sure, on [1004] September 23, 1935, entitled, "Order appointing trustees." May I refer the Court at page 3 of the copy of this order which has just been received of record. I desire to read the text commencing at line 3 and extending through line 7.

"And it appearing to the court that the creditors and stockholders of the debtor represent that the appointment of trustees herein should not disturb the continuity of operations by the corporate organization of the debtor and should be at minimum cost to the debtor";

I now turn to page 4 of this order and ask leave to quote the entire text of paragrph 2, which commences on line 27 of that page:

"That said trustees shall have all the title and shall exercise, subject to the control of this court and consistent with the provisions of said amendatory Section 77, all of the powers of trustees appointed pursuant to Section 44 of said act; and, to the extent not inconsistent with said amendatory Section 77, the powers of a receiver in equity proceedings; and, subject to the control of this court and jurisdiction of the Interstate Commerce Commission, as provided by the Interstate Commerce Act as now or hereafter amended, the power to operate the business of the debtor, which business shall be conducted in the name of the debtor by its regularly elected or appointed corporate officers, agents and [1005] employees, but under and subject to the direction of said trustees."

May I just add, if your Honor please, that I have quoted this text in part for the purpose of showing that it was by order of the court that the trustees were to conduct the business in the name of the debtor and be its regularly appointed officers, agents and employees.

May I also direct the Court's attention to paragraph 3 of this order on page 5, which I think will be responsive to the inquiry made by the Court a moment ago. Perhaps I should read that paragraph. It is quite brief, commencing at line 10:

"That said trustees shall have all of the powers, rights, privileges, duties and obligations heretofore granted to or imposed upon the debtor pursuant to the order of this court entered herein August 2, 1935, and any and all orders supplementary thereto or amendatory thereof; and each and all of the orders heretofore entered in this proceeding shall, with respect to the said trustees and the property of the debtor, be of like force and effect as though said trustees were therein specifically named in the place of the debtor, all of said orders being hereby incorporated in and made a part of this order by reference."

If the Court please, I should simply add that by paragraph 1 of this order on page 4 the Court appoints three trustees, namely, [1006] T. M. Schumacher, Chairman of the Executive Committee of the debtor; Charles Elsey, President of the debtor; and Sidney M. Ehrman.

I desire to offer as our next exhibit a copy of the

opinion and order of Judge St. Sure entered in the reorganization proceedings on November 9, 1935, entitled "Opinion and order confirming the appointment of trustees as appointed by the court and ratified by the Interstate Commerce Commission."

(Document referred to was thereupon received in evidence and marked Defendant's Exhibit No. 22.)

Mr. Matthew: I think that the Court will allow me to state, in order to save a little time, that when the order of the court appointing the three trustees was considered by the Interstate Commerce Commission, the Commission concluded that there shall be no more than two trustees for the Western Pacific and accordingly it determined to approve the appointment.

The Court: The court appointed two trustees and appointed Mr. Elsey as manager.

Mr. Matthew: They thought two trustees should suffice for this property, and accordingly the Commission approved the appointment of Mr. Schumacher and Mr. Ehrman, and so of necessity the matter again came before the court with the result that this opinion and order which has just been received as Exhibit No. 22 was issued and assigned by the court. I think that all of the text of this opinion and order is pertinent, as your Honor will [1007] find, but I desire to read only a portion of it. I am now reading from the second page of this opinion and order commencing with the text in

the fourth line from the bottom of the page. May I say by way of interpolation the court is referring here to its prior order of appointing three trustees. I now quote:

"Subsequently to the order referred to, the Bankruptcy Act was amended by Congress making it mandatory upon the court to appoint one or more trustees——"

May I interrupt the quotation because I have misstated. The court is here referring to its initial order which contemplated that there would be no trustees but the property should be operated by the debtor with Mr. Elsey as its president. May I now resume the quotation because I think that clears a misconception of which I was guilty.

"Subsequently to the order referred to, the Bankruptcy Act was amended by Congress making it mandatory upon the court to appoint one or more trustees, and providing that if one who was connected with the debtor were appointed, there should also be appointed one who had no such connection, such appointment to be subject to confirmation by the Interstate Commerce Commission. Immediately upon such amendment being made, the Court proceeded on formal hearing in the manner required by the act to appoint trustees for the property of this [1008] particular debtor. The court desired that at least one trustee should be a person residing within the district, experienced in railroad management, and familiar with the railroad of the particular debtor, and in whom the court had con-

fidence. Such a person was Mr. Elsey. The large creditors of the debtor and the controlling stockholding interest in it requested the appointment of Mr. T. M. Schumacher, Chairman of the Executive Committee of the debtor, representing that he had conducted all negotiations looking to the formulation of a plan of reorganization. Mr. Schumacher had his residence and his office in New York. The court was willing to accede to this request provided there was also appointed as trustee one who resided and had his office in this district and could attend to the immediate management and operation of the property. The selection of Mr. Elsey and Mr. Schumacher required the selection of a third trustee not connected with the debtor. As such trustee the court selected Mr. Sidney M. Ehrman, a lawyer of large experience, in whose discernment, judgment and integrity it had full confidence."

May I remind the court on that showing of the record that at the time when this appointment of trustees was made, Mr. Schumacher was the president of the plaintiff corporation. He was also the highest officer of the debtor company, being the chairman of the [1009] Executive Committee, as I recall it, and when the court says, as it does in the text which I have quoted, that the largest creditors of the debtor and the controlling stockholding interests in it requested the appointment of Mr. T. M. Schumacher, it will be understood that this controlling stockholding interest was the plaintiff corporation, namely, the holding company which owned all of the stock in the debtor company.

The Court: This order sort of demonstrates the folly of having some administrative agency 3000 miles away tell the court, which is right here in control of the situation, that it could only appoint two trustees instead of three; so the court has to go through a lot of roundabout motions in order to accomplish that which is obviously the proper thing to have done. Not that it is pertinent to this proceeding, but this order and Judge St. Sure's opinion is very clarifying on that subject.

Mr. Matthew: I think the court's observation is generally pertinent in any event. And may I add this further comment, that we have in this order and in the prior order the explanation, at least a factual explanation for the creation of the so-called dual relationships which existed throughout the trusteeship, and which have been referred to from time to time in the course of this trial. And by the order of the court, paragraph 1, the fourth page, the court orders that T. M. Schumacher and Sidney M. Ehrman be and the same are the trustees of the properties of the debtor, duly appointed by this court and ratified [1010] by the Interstate Commerce Commission.

May I now pass to the next succeeding page and to paragraph 3 of this order:

"That said trustees be and they are hereby instructed and directed to engage Charles Elsey as their agent, to operate and manage the railroad and properties of the debtor."

I now read paragraph 4:

"That said trustees shall have all the title, and shall exercise subject to the control of this court and consistent with the provisions of amendatory Section 77 of Chapter 8 of the Act of Congress relating to bankruptcy, all of the powers of trustees appointed pursuant to Section 44 of said Act, and to the extent not inconsistent with said Section 77, the powers of a receiver in equity proceedings, and subject to the control of this court and jurisdiction of the Interstate Commerce Commission as provided by the Interstate Commerce Act as it now exists or hereafter may be amended, power to conduct the business of the debtor with authority to them to conduct such business to the extent that they deem advisable in the name of the debtor and by its officers, agents and employees."

I ask leave to read one further paragraph, which is comparatively brief, and that is paragraph 5:

"That these trustees shall have all the powers, rights, privileges, duties, and obligations heretofore granted to or imposed upon the debtor by the order of this Court entered herein August 2, 1935, and any or all orders supplementary thereto or amendatory thereof, and each and all of the orders heretofore entered in this proceeding shall, except so far as the same are not inconsistent with the express provisions of this order, be of like force and effect with respect to the said trustees and the property of the debtor as though said trustees were therein specifically named in the place of the debtor, all of said orders being hereby incorporated in and made a part of this order by reference."

I think that paragraph will further respond to your Honor's inquiry as to whether certain authorities conferred by the intial order were likewise carried into effect in the orders appointing the trustees.

I now desire to offer as our next succeeding exhibit the copy of an order signed and filed by the reorganization court on December 17, 1943, entitled "Order authorizing and directing transfer of preferred and common stock of the debtor to the reorganization committee and approving action of the committee in joining in a contract for securing control of such stock and acts of the committee in connection with such contracts."

(The document referred to was thereupon received in [1012] evidence and marked Defendant's Exhibit 23.)

Mr. Matthew: The Court will have in mind that this order is related particularly to an agreement which has been referred to in this proceeding, namely, the agreement dated November 22, 1943, between the Western Pacific Railroad——

Mr. Adams: Plaintiff's Exhibit 11.

Mr. Matthew: Plaintiff's Exhibit 11—between the Western Pacific Railroad Corporation and its secured creditors and the reorganization committee, whereby it is provided among other things that the holding corporation would upon the request of the reorganization committee transfer to the committee or to its nominee all of the stock in the debtor com-

pany held by the plaintiff corporation. The reorganization committee had petitioned the court for the approval of that contract. [1013]

Mr. Matthew: I desire to read into the record at this point a portion of the order of the Court:

"Now therefore it is hereby ordered, adjudged and decreed: (1) That the Western Pacific Railroad Corporation, in order to carry out and make effective the plan of reorganization of the debtor, be and hereby is, directed to assign, transfer and deliver or cause to be assigned, transferred and delivered, to the reorganization committee or its nominee, all of the preferred and common stock of the debtor company, provided that such assignment, transfer and delivery shall be made at the time and place fixed in a written request of the reorganization committee;

"(2) That the action of the reorganization committee in joining in and becoming a party to the agreement dated November 22, 1943, with the Western Pacific Railroad Corporation and its secured creditors, a copy of which was filed with the Court on December 1, 1943, be and the same hereby is, in all respects, approved;

"(3) That the reorganization committee is hereby authorized in its discretion to make written request upon the Western Pacific Railroad Corporation for the assignment, transfer and delivery of [1014] the preferred and common stock of the debtor company and for such other action by the Western Pacific Railroad Corporation as the re-

organization committee may deem necessary or convenient for the purpose of carrying out and making effective the plan of reorganization of the debtor, and the reorganization committee is authorized to accept transfer of such stock for the purpose of carrying out and making effective the plan of reorganization of the debtor."

I think I need not read the fourth and final paragraph, which is not immediately pertinent to what I have in mind.

May I direct the Court's attention to the fact that the order of the reorganization court entered on March 3, 1944, upon the petition of the reorganization trustees, authorizing the trustees to set aside a reserve fund in the sum of $7,100,000 for contingent tax liability, has been received of record as Defendants' Exhibit No. 12. May I just state to the Court that for its convenience in examination we have reproduced in the appendix to this memorandum, commencing on page 6, the whole text of that order of the Court. It is very brief, and in its entirety is found on page 6 of Appendix A. I now offer as our next succeeding exhibit a copy of a petition of the reorganization committee filed in the reorganization court on August 23, 1944, entitled "Petition of Reorganization Committee [1015] for an Order Approving Use of the Debtor Company in Carrying Out and Making Effective the Plan Approving Proposed Amendments to the Articles of Incorporation and Proposed New By-Laws of Debtor Company and Approving Forms of Pre-

ferred and Common Stock Certificates, and Directing Action with Respect Thereto."

Mr. Phleger: I might point out that we introduced that as Plaintiff's Exhibit 12.

* * *

Mr. Matthew: The Court has heretofore received in evidence as Plaintiff's Exhibit No. 12 a copy of the petition of the reorganization committee filed on August 23, 1944, for an order approving mortgage indentures and certain other forms, and also for authority to make certain adjustments payments. [1016] I would like to refer to, and quote, one brief paragraph from that petition. This is subparagraph (c) in paragraph 11, and this paragraph relates to the earnings which has been realized from the operation of the properties in the hands of the trustees from January 1, 1939, through the calendar year 1943, subject to the following comments, and certain of these comments are in subparagraph (c), which I read as follows:

"The amount of such earnings for the calendar year 1943 is before deduction of a special funded tax reserve which has been set up in the amount of $7,100,000. However, after deduction of such reserve, there would still remain the amount of $11,583,299.07, which would have been available under the provisions of the plan for the payment of full interest on the general mortgage income bonds, the sinking fund requirements and a dividend of 5% on the preferred stock. And after such payment a balance of $8,929,844.07, available for dividends,

on the common stock and for other corporate purposes, would have remained."

There has also been received as Plaintiff's Exhibit 13 a copy of the court order of September 25, 1944, responsive to the petition to which I have just referred, approving the mortgage indentures and other forms, and also authorizing the adjustment payments to which I have previously referred. I would like to quote briefly from that order of the court. This is paragraph 6, appearing upon page 7 of the copy furnished for the record. I now read:

"That the balance of the available net income of the debtor and its subsidiaries for the years 1939 to 1943 inclusive, remaining after the payments directed in paragraph 5 hereof, be applied as follows:

A. $1,698,562.25 to be credited by the reorganized company to the capital fund account within 30 days after the consummation of the plan; provided, however, that such account shall be reduced prior to, or at the end of, such 30 day period, to $1,000,000, either by proper charges to such account under the provisions of the plan or by reducing said account by the amount of the excess over $1,000,000.

B. $424,360 to be applied to the making of the sinking fund payments required by subdivision L of the plan in respect to the general mortgage, 4½% income bonds, Series A and C; $20,658,938.92, or the remaining balance of said available net income, to be applied to any proper corporate purpose [1018] of the reorganized company."

I now desire to offer as our next succeeding exhibit a copy of an order entered by the reorganization court on October 23, 1944, entitled, "Order Approving Designation by the Reorganization Committee Under the Plan of Reorganization of the Debtor of the Trustees, Transfer Agents, Registrars, Scrip Agents, Depositary and Exchange Agent, and Engraver and Printer of Securities, for Purposes of the Plan of Reorganization and Authorizing Agreements or Arrangements Proposed by Said Committee for their Compensation and Expenses."

And if I may continue the offer for a moment, I also offer a copy of the order made by the reorganization court on the same date, namely, October 23, 1944, entitled "Order Making an Allowance to be Paid out of the Debtor's Estate for Certain Expenses Incurred and to be Incurred in Connection with the Proceedings and Plan or Reorganization by the Reorganization Committee."

I think I should state to the Court and to counsel that I attach no particular significance to either of these two orders. They are offered for the record merely for the purpose of accounting for them in this respect: In the final order of the court terminating the proceedings, there is a reference to a reservation of authority over expenses made by an order of the court entered on October 23, 1944; so without these two orders in the record we might not have fully accounted [1019] for the orders which are referred to by certain dates or otherwise in the final order of the court. For that purpose

only I offer these two orders to which I have just referred.

The Clerk: Are you offering them as one exhibit?

Mr. Matthew: Well, I would think it might be preferable to have them given separate exhibit numbers, but I will defer to the custom. I think they could be designated separately. They are companion orders.

The Clerk: 24-A and -B.

(Orders of reorganization court of October 23, 1944, were received in evidence and marked Defendants' Exhibits 24-A and 24-B.)

Mr. Matthew: The Court has also heretofore received as Plaintiff's Exhibit No. 14 a copy of the court order of November 27, 1944, directing the revesting of the debtor's property in the reorganized company and authorizing and directing the carrying out of the plan. I ask leave of the Court to quote rather extensively from that order. It is one of the most important orders in the reorganization proceeding. It is very important, or has a direct bearing upon various issues in the case—particularly upon the defenses predicated upon the bars of the reorganization proceedings. [1020]

* * *

I would like to read first a brief paragraph, (e), in the preliminary findings of the court in this revesting order, November 27, 1944, subparagraph (e), reading as follows:

"The proposed agreement attached to this order as Exhibit D provides for the assumption of obligations, liabilities, contracts, agreements and leases which are to be assumed by the reorganized company pursuant to the plan of reorganization. It is consistent with and conforms to the plan of reorganization and should be approved."

I now read a part of paragraph 9 of this order:

"The Western Pacific Railroad Company shall assume and agree to perform all contracts, leases and agreements made or entered into by the debtor in possession or by the debtor's trustees and remaining in effect on the date of the actual delivery of possession by said trustees and the actual termination of the responsibility of the debtor's trustees for the operation of the debtor's properties as hereinafter provided in this order, and which have heretofore been assumed [1024] or not disaffirmed by said trustees which remained in effect on December 31, 1944, together with the expenses of this reorganization as allowed by the court within the maximum fixed by the Interstate Commerce Commission."

Now I come to a later portion of this same paragraph 9 of the order, being a part of subparagraph (e), and before I undertake to read that text, may I ask the Court to have in mind that included in the text is a reference to the agreement of assumption and certain language of the order which we think is very pertinent as to its meaning and effect. I now read:

"And, further, without limitation of the generality of the obligations hereinabove imposed upon the Western Pacific Railroad Company, that company shall (a) specifically assume and agree to pay in cash the face amount of any and all outstanding first mortgage bond coupons which matured on or prior to September 1, 1933"—I omit some further text there relating to the payment of the coupons, which is not immediately germane to what I have in mind—and also simply refer to item (b), which refers to the payments of taxes to the United States from the debtor or the debtor's trustees. I now continue: "The above ordered [1025] assumption and adoption shall be evidenced by the execution by said railroad company of the agreement of assumption referred to in paragraph '8(a)' above and of such other instruments of assumption as may be appropriate; and said railroad company shall succeed to all rights, privileges, liabilities and duties of the debtor or the debtor's trustees under such contracts, leases and agreements; provided, however, that this order shall not be construed as a modification of any former orders of this court barring or settling claims against the debtor or the debtor's trustees, and said railroad company shall assume only the valid and outstanding obligations and liabilities of the debtor or the debtor's trustees, other than unsecured claims against the debtor not entitled to priority over existing mortgages, which unsecured claims are hereby canceled and discharged, and only such obligations and liabilities

as are preserved under the plan of reorganization and are not limited or discharged by the prior orders of this court."

I will omit reading paragraph 10. I think that paragraph has been reproduced in Appendix 8 to our preliminary memorandum. I do desire, however, to read a portion of paragraph 11:

"The date for the consummation of the plan of reorganization, and the date upon which the first mortgage bondholders and secured creditors of the debtor shall be entitled to receive in exchange for their old securities, the new securities and adjustment payments under the plan, as heretofore approved and authorized by this court, is hereby fixed as December 29, 1944; all of the business, assets and property constituting the debtor's estate, of every kind and character, real, personal and mixed, and all of the right, title and interest therein of T. M. Schumacher and Sidney M. Ehrman, as trustees herein, shall vest in and be and become the absolute property of the Western Pacific Railroad Company on said date, free and clear of all rights, claims, liens and interests of said trustees, the former stockholders and creditors of the debtor, and of all other persons, firms and corporations whatsoever, except as is otherwise provided in this order, and the said railroad company shall thereupon be forever released and discharged from all of its debts, obligations and liabilities, except as herein provided;"

I think I need not read further from that paragraph.

May I just refer the Court very briefly to paragraph 15 of the same order, which I need not read. It will suffice if [1027] I characterize it as being the conventional injunction against suit and actions against the reorganized company.

I shall finally direct the Court's attention to the closing paragraph of the revesting order, namely, paragraph 20, which shows the extent to which jurisdiction has been reserved. I shall take only a moment to read it:

"This court reserves jurisdiction for all purposes necessary to put into effect and carry out this order and the plan of reorganization, including, without limiting the generality of this reservation, the right to enter, upon such notice as this court may direct, any further order or orders terminating the right to receive any securities or payments of cash under the plan of reorganization; and this court expressly reserves jurisdiction to determine all costs and expenses of administration, including the amounts to be paid as compensation for services heretofore or hereafter rendered or reimbursement for expenses heretofore or hereafter incurred by the reorganization committee and its attorneys, or by any other person, firm or corporation, in connection with this proceeding and the plan of reorganization, and generally in connection with putting into effect and carrying out the plan of reorganization." [1028]

I think I need not read further from that particular order.

I think that the ninth and final report of accounting of the reorganization trustees has not yet been offered in evidence. I offer at this time a copy of the ninth and final report and accounting by the trustees of the property of the debtor and petition for approval of their acts and accounts and for their discharge as trustees and for the exoneration of their bonds filed in the reorganization court on April 30, 1945, and I ask that it be received as the next succeeding exhibit number.

(The document referred to was received in evidence and marked Defendants' Exhibit 25.)

Mr. Matthew: I offer next copies of the court order of May 21, 1945, approving the ninth and final report and accounting of the reorganization trustees and discharging them as trustees, signed and filed on May 21, 1945. I think that a copy of that has not yet been received in evidence, although reference has been made to it. I see that I failed to bring a copy of that particular order with me. Might I ask the Court for an exhibit number at this time and to produce it at the next session of the court on Tuesday?

The Court: Very well.

(The document referred to was received in evidence and deemed marked Defendants' Exhibit 26.)

Mr. Matthew: I now offer a report of the reorganization [1029] trustees filed in the reorganization court on May 21, 1945, entitled briefly, "A Re-

view of the Operations of the Company's Railroad in the Jurisdiction of the District Court of the United States for the Northern District of California During Proceedings for Reorganization under Section 77 of the Bankruptcy Act, August 2, 1935, to December 31, 1944."

Copies of this report were transmitted to all parties of record to the reorganization proceeding and to all counsel for the parties, as shown by an affidavit in our files. May I state that this is a rather convenient review of the entire period of the trusteeship, which was received by the court at the time when the trustees were heard upon their petition for the approval of their ninth and final report and accounting and for their discharge. It has in it likewise certain historical matter which may be of some interest to the Court. I do not offer it for any but a single purpose. I desire to offer it for the text appearing on pages 43 and 44 under the title "Income and Excess Profits Taxes 1943 to 1944."

Mr. Phleger: May it please the Court, I do not think this should be admitted in evidence. It is a printed document of some sixty pages or over. It is not a document upon which the court acted at all. I am willing, if counsel so states, to agree that the two paragraphs he refers to were in fact filed by the court, if that is all he wants to prove by it, but frankly, I have never seen it before and it contains a multitude [1030] of recitals of fact running back for years. I do not know what you seek to

prove, Mr. Matthew. Maybe I can accommodate you by a stipulation.

Mr. Matthew: Well, if the Court please, one of the matters of controversy in this case is the extent to which notice of these income tax returns and the use of the stock loss in the consolidated returns, with the resultant reduction in tax liabilities, has been brought home to the parties in the cause, including particularly the plaintiff corporation and its counsel. We have here a report of the trustees made to the court, reviewing their entire period of service, and again including very specific text about the income and excess profits taxes for the so-called critical period of 1942, 1943 and 1944. I have in my file here an affidavit showing that copies of that report were transmitted on the 22nd day of May, 1945, to a rather considerable list of persons, including the Western Pacific Railroad Corporation, its counsel, Mr. Nicodemus, and, if you will pardon me, Mr. Phleger, a copy also went to your firm, which, as you know, at that time was counsel to, I think, the Reconstruction Finance Corporation, counsel of record. It seems to me whenever we bring home fair notice in these official publications served upon the counsel to the plaintiff corporation and served upon the corporation itself of the essentials of these income tax returns, we have some evidence which is of definite value and important to our defenses. [1031]

* * *

Mr. Matthew: That is it.

The Court: And what gave rise to the discussion was whether or not that notice, at that time, had legal validity; and I take it that you can stipulate, I suppose, that you are only offering that portion of this report on pages 43 and 44, that have to do with the tax matters.

Mr. Matthew: That is true, and I am willing to withdraw my offer of the document in its entirety, if it is desired, because it is perhaps more comprehensive,—but I would like to read into the record at least the text to which I have referred.

Mr. Phleger: Your Honor, I have no objection to his doing that, if he will also state the date on which he states that it [1036] was sent out to this list.

Mr. Mathew: I can give you that date.

Mr. Phleger: I am not admitting its relevancy, your Honor; I will stipulate to it subject to our objection as to relevance.

Mr. Matthew: Well, I have in my files an affidavit or a copy, made on the 22nd day of May, 1945, by——

Mr. Phleger: What is the date?

Mr. Mathew: The date of the affidavit is May 22, 1945, and it recites that on the 15th day of May, 1945, copies of this report were mailed to each of the parties named on this list, and among them are, as I stated, the Western Pacific Railroad Corporation and Mr. Nicodemus.

Now I don't want to carry the argument to the court any further as to what might be the scope of

the jurisdiction of a court, but I am very certain that there is a period in there in which that claim might well have been entertained by the court, and that will require a good deal of discussion when we come to arguing the defenses of the bar.

The Court: Yes.

Mr. Matthew: And I wouldn't want to mislead your Honor as to just how far that argument, or in what respect that argument will go. There are a good many important legal principles and qualifying principles involved. But I do think it is important to our case and perfectly in order, to bring home to the plaintiff corporation and its counsel the fact that at this [1037] particular time a copy of this report was at least sent to them, and that it did have this text, referring to the income and excess profits taxes for the years 1942, 1943 and 1944.

Now is it the court's suggestion that the offer of the entire document be withdrawn, and that I may offer the text to which I have referred——

The Court: I think that would be better, Mr. Matthew.

The Clerk: The offer is withdrawn.

Mr. Matthew: Then I withdraw the offer of the review in its entirety, and I ask leave to read into the record a paragraph found on pages 43 and 44 of the report to which I have referred, under the caption, "Income and excess profits taxes 1943, 1944."

"The income account of the trustees, appendix A,

show that no federal income or excess profits taxes were accrued for the year 1943 or the first four months of 1944. For those periods, as for the several preceding years, tax returns were filed on a consolidated basis by the Western Pacific Railroad Corporation, a holding corporation which was the owner of all of the capital stock of the railroad company until May 1, 1944, when all of said stock was transferred to the reorganization committee as part of the procedure for effectuating the plan of reorganization. The trustees were advised that they had no liability for federal income or excess profits [1038] taxes in 1943 or the first four months of 1944, because of the loss suffered by the holding corporation when the United States Supreme Court finally approved the reorganization plan, which rendered the railroad Company's capital stock 'without equity or value'.

"However, the commissioner of Internal Revenue has not audited the 1943 and 1944 returns, and the reorganization trustees, pursuant to authority of the court, established a reserve fund in the amount of $7,100,000, to provide against the contingency that some tax liability of the railroad company might subsequently be asserted by the commissioner of Internal Revenue for the year 1943."

Then follows a sentence in parenthesis, reading as follows:

"(The Board of Directors of the company, on March 26, 1945, established an additional reserve fund in the amount of $3,000,000, to cover a similar

contingency in respect of the first four months of 1944)".

Mr. Phleger: Just a moment; I am puzzled. That recites that the returns have ben filed for '44, but have not yet been audited. According to the dates you gave, Mr. Matthew, that was sent out a month before the 1944 returns were filed.

Mr. Clark: That is exactly what I was going to say.

Mr. Adams: After the tentative returns and before the final returns had been filed.

Mr. Phleger: How could they be? Well——

Mr. Clark: No, this language is, may it please, your Honor, "The income account of the trustees, appendix A, shows that no federal income or excess profits tax were accrued for 1943 or the first four months of 1944. For those periods, as for several preceding years, tax returns were filed on a consolidated basis by the Western Pacific Railroad Corporation, a holding corporation, etc.,——"

Now this document, so reciting, went out according to the date given by Mr. Matthew, on May 15; but the returns which it recites were filed for the four months of 1944 were not actually filed until June 15 of 1945. In other words, they hadn't been filed at the time this was so reported.

Mr. Adams: Well, now, counsel will stipulate, no doubt, your Honor, that the tentative returns—and that tentative return was a tentative return of the plaintiff corporation for the year 1944—were filed in March, 1945?

Mr. Clark: No, the only return we know about is the one filed on June 15, 1945.

Mr. Adams: Well, we are speaking of the final return.

Mr. Clark: Right. For the first four months of 1944.

Mr. Phleger: No, I think there was an extension of time; but no returns were field. [1040]

* * *

Mr. Adams: Now, if your Honor please, if I might interrupt for a moment so that we might have the record correct; and I think counsel, if I call counsel's attention to Interveners' 80, a document not in the record in this case, but taken upon depositions, that we can get a stipulation without the necessity of introducing Interveners' 80.

Mr. Clark: Wait just a moment until we get it.

Mr. Adams: Please do. Look at the second paragraph.

Mr. Phleger: I think that the exhibits in evidence will show that an extension to file the returns was granted contingent upon tentative returns being filed; so I would assume they were filed.

Mr. Adams: I made a statement, and I would like to get the statement and the record cleared up.

Mr. Phleger: I think it is right in the record now, Mr. Adams, in the exhibits which we introduced, and the 1944 tax return. It is included in there. [1041]

Mr. Adams: Well, if your Honor please, may I

simply have the record cleared up right now, and I think it can be if counsel, all of whom want to have the facts correctly stated, will refer to Interveners' Exhibit 80. I think they will find confirmation, this being a telegram of Mrach 1, 1948, speaking of the fact that "There is to be filed a tentative consolidated return for the corporation for the entire year, including its subsidiaries to May 1."

I think your Honor will find, if counsel will agree, that that was the procedure that was followed.

Mr. Clark: Well, I think maybe your Honor would find it best simply to put this——

Mr. Phleger: I don't think you have to do that. The exhibit in evidence shows the application for extension of time, and it shows the tentative return. This is Plaintiff's Exhibit for the year 1944.

Mr. Adams: Yes, and the tentative return filed covered the corporation for the whole year and the subsidiaries for the first four months.

Mr. Phleger: Correct.

The Court: So that when they refer to this excerpt that Mr. Matthew has been reading from to a return for 1944, they are referring to a tentative return, rather than the final return?

Mr. Phleger: Yes.

Mr. Adams: Well, I think the significant fact is, your [1042] Honor, that the tentative return was a return of the holding company for the whole year and for the subsidiaries for the first four months; so that that had become a determined procedure before this report was put out.

Mr. Matthew: May I just make this further comment, without encroaching upon your Honor's patience further? Irrespective of any possible inaccuracy in that particular statement as to the 1944 returns, of course the important and significant part of this text is that the part which relates to the fact that the stock loss of he holding company was used in the returns, with a resultant deduction in tax liability——

The Court: You have read that part, Mr. Matthew, and called attention to the fact that it was included in this report and then the report was mailed out to the various persons whom you named.

Mr. Matthew: Yes. May I just add this, if your Honor please: I haven't responded fully to your Honor's inquiry as to the powers and jurisdiction of the reorganization court and other courts, but in due course I know we will bring to your Honor many authorities which deal with the question of jurisdiction, and to what extent that jurisdiction may be reserved or has been reserved, and it would take a fairly considerable time to deal with those issues right now. So I trust your Honor will understand that in due course we will cover that field very fully. But we think that this particular text, having been [1043] brought to the attention of counsel for the plaintiff corporation and the corporation itself, as of the date shown, is pertinent to the case. I take it that your Honor may desire to adjourn at this time?

The Court: You have some more documents that you are going to put in, Mr. Matthew?

Mr. Matthew: Yes, but they would take some little while. May I suggest this, if your Honor please: We would like to offer for the record the chart which has been prepared by us and which has been hanging in the courtroom, and which counsel have no doubt examined, that of reorganization and tax chronology from 1935 to 1947. I think that every order therein listed has been covered, either by exhibits offered by plaintiffs or interveners or by defendants, with the exception of the closing order, March 28, 1946. Reference has been made to that order, and it will be offered. I think that the data on the chart is correct, at least as to the best of our knowledge and belief, and I simply call to the Court's attention the fact that in the scheme on the left-hand side of the chart we segregate the operations in 1935 with the debtor in possession, from the succeeding operations by the reorganization trustees to the end of 1944, followed by the period mentioned in 1945 when the property was revested, and thereafter operated by the reorganized company. We would like to offer that chart in evidence.

Mr. Phleger: May it please the Court, we will check that [1044] over the week-end; I don't know, I haven't examined it. Perhaps it is all right, but we would like to look at it. We probably will be able to stipulate.

The Court: You are offering it as a summary of the evidence offered by the defendant?

Mr. Matthew: Yes, to the extent that it appears on the chart. We have here a chronology of significant orders and significant events which we think will be helpful to the Court.

The Court: I will admit it for the same purposes I admitted the plaintiff's chart and to the same extent; and if you want to correct anything on it, you may correct it.

The Clerk: 27.

(Chart referred to, defendants' reorganization and tax chronology from 1934 to 1947, was received in evidence and marked Defendants' Exhibit 27.) [1045]

* * *

Mr. Matthew: If the Court please, may the record show that I have this morning handed to the Clerk for incorporation into the record a copy of the court order of May 21, 1945, approving the ninth and final report of the reorganization trustees and discharging them as trustees. I offered that report at Friday's session, the offer was accepted and the court assigned Exhibit No. 26 to it. I now furnish a copy for the record and have likewise furnished copies to counsel.

The Court will recall that toward the close of the last session, we offered and the Court received as Exhibit No. 27 the reorganization and tax chronology chart covering a period from 1935 to 1947,

which hangs upon the easel here in the courtroom (indicating).

May I call the Court's attention at this time to a further chronology which has been incorporated as Appendix B in the defendant Western Pacific Railroad Company's preliminary memorandum. That chronology is a little more comprehensive than the chronology which appears on Exhibit No. 27. The Court will notice that it has been prepared in two parallel columns, the one to the left being identified as the chronology of reorganization proceedings and the one on the right in red type, being [1046] identified as the chronology of tax returns and related occurrences.

We believe that the chronology there shown is accurate and since it is somewhat more complete, that is, has more detail in it, than the chronology appearing on Exhibit No. 27, we think the Court will find it available for convenient reference and have some assistance from it in that respect.

We would now request that the opinion and order of the Interstate Commerce Commission approving the plan of reorganization of the Western Pacific Railroad Company, issued under date of June 21, 1939, given docket No. 10913 and reported in 233 I.C.C. 409, be deemed to be a part of the record in this proceeding. I am inclined to think that that was the intent of counsel for the plaintiff in referring to the Commission's report and order. He quoted briefly from it. As I understood, the implication at least of his observation was, that that was his thought at the time.

Mr. Phleger: That was our intention.

Mr. Matthew: Yes, very well.

Now that is understood, we are content. And may I also suggest in that connection that the earlier opinion and order, the Interstate Commerce Commission in the same proceeding—that is, the opinion and order dated October 10, 1938, and reported in 230 I.C.C. 61—be likewise deemed a part of the record in this proceeding. [1047]

I make that request particularly because that is in some respects a little more comprehensive as to history of the Western Pacific Railroad Company and of the reorganization proceeding. Of course the plan which was originally promulgated in that earlier report was modified by the later order of the Commission to which I have already referred.

Mr. Phleger: No objection.

Mr. Matthew: Very well.

I now offer a copy of the Court order of Feb. 21, 1944, entitled, "Order providing for hearing upon petition for authority to establish reserve fund for contingent liabilities." The Court wlil have in mind that the petition of the trustees is in evidence as plaintiff's Exhibit No. 58 and that the court order granting the petition for the establishment of the fund is in evidence as Defendant's Exhibit No. 12. We would also like to have in evidence this court order of Feb. 21, 1944, providing for a hearing upon the petition and fixing a date for it.

The Clerk: Exhibit 28.

(Court order dated Feb. 21, 1944, referred to above, was thereupon received in evidence and marked Defendant's Exhibit 28.)

Mr. Matthew: Now may I request a stipulation from counsel that on the 23rd day of February, 1944, copies of the petition of the trustees in this matter, together with copies of the order providing for a hearing upon the petition, just received as Exhibit No. 28, were mailed to all parties of record, including [1048] the Western Pacific Railroad Corporation, as well as to counsel, including Mr. Nicodemus and Judge Sloss. I am prepared to make that proof, but I think counsel may be willing to accept that as a stipulation.

Mr. Phleger: We will.

Mr. Clark: So stipulated.

Mr. Matthew: We now offer a copy of the court order of December 11, 1939, granting the petition of intervention of the Western Pacific Railroad Corporation.

The Clerk: Exhibit No. 29.

(Copy of court order dated December 11, 1939, referred to above, was received in evidence and marked Defendant's Exhibit No. 29.)

Mr. Matthew: May I say, with the approval of Court and consent of counsel, that this order granting the petition of intervention of the Western Pacific Railroad Corporation was made upon the petition of the Western Pacific Railroad Corporation, which was filed by Judge M. C. Sloss of the

firm of Sloss, Turner & Finney, on December 7, 1939; order granting leave to file the petition of intervention was dated December 7, 1939. I think it is unnecessary to offer for the record either the petition of the corporation to which I referred or the preliminary order made by the Court granting leave to file it. Is that statement acceptable to counsel?

Mr. Clark: Yes, indeed. [1049]

Mr. Phleger: Yes.

Mr. Matthew: That last exhibit——?

The Clerk: That last number was 29.

Mr. Matthew: We next offer a copy of the petition of the reorganization committee for approval of their expenses and for a final order discharging the committee and terminating the proceedings in the reorganization court, filed in the reorganization court on March 18, 1946.

The Clerk: Exhibit 30.

(Copy of petition and order of March 18, 1946, was thereupon received in evidence and marked Defendant's Exhibit No. 30.)

Mr. Matthew: I next offer a copy of the order of the court entered on March 18, 1946, entitled, "Order providing for hearing upon petition of reorganization committee for approval of their expenses and for a final order discharging the committee and terminating the proceeding.

Mr. Phleger: This is the committee, as distinguished from the trustees?

Mr. Matthew: Oh, yes, and the petition which has just been received in evidence is a petition of the committee.

Mr. Phleger: I understand, correct.

Mr. Matthew: And this is the order of the court providing for a hearing upon the petition.

The Clerk: No. 31.

(Court order dated March 18, 1946, was thereupon received [1050] in evidence and marked Defendant's Exhibit No. 31.)

Mr. Matthew: I desire now to offer a copy of the final order of the reorganization court, responsive to the petition which has just been received, signed on March 28, 1946.

The Clerk: Exhibit 32.

(Final order signed March 28, 1946, was thereupon received in evidence and marked Defendant's Exhibit No. 32.)

Mr. Matthew: The Court may recall that I had in mind perhaps reading some portion of the text of the final order which has just been received; but it seems to me upon reflection that the Court's observations in that connection are well advised, and now that we have physically in the record a copy of that final order, it will serve no useful purpose and would simply be time-consuming to read any part of the text of that order into the record. But may I call the Court's attention to the fact that we have reproduced in Appendix A to the preliminary memorandum of defendant, the Western Pacific

Railroad Company, certain portions of the text of that final order appearing upon pages 11 to 14 inclusive of Appendix A. Of course the Court will understand that we rely upon the entire text of that final order.

May I state to the Court that we have no further documentary material to offer at the present time from the record in the reorganization proceeding. It is possible that we might hereafter ask leave to supply additional documentary material [1051] from that record, but as we are presently advised, we have nothing further in prospect to offer from that record.

Mr. Adams: If your Honor please, upon the opening day's session of court, your Honor inquired (the reference is page 11 of the transcript) with regard to the effect of the plan upon the elimination or reduction of creditors' claims. At that time I made a response which was inaccurate, and I would like to correct it. I refer to the statement beginning at the bottom of page 11 and over on page 12, and particularly the statement on page 12, lines 10 to 13, in my response, which I stated, "One of the secured creditors, the A. C. James Company, was not fully paid." That is correct. Then I said, Page 12, lines 10 to 13, "The amount is not decipherable from the decision of the Supreme Court or the Interstate Commerce Commission. I think that is a correct statement."

Now the fact is, your Honor, having looked at this further, the precise amount by which the A. C.

James Company was not paid is, I believe, decipherable from the record; and I have prepared a memorandum on one page quoting paragraph 5 of paragraph P of the plan as prescribed by the Interstate Commerce Commission and then stating certain figures; that is to say, the figures that appear in paragraph 5 as to the amount of the claim of the A. C. James Company and as to the securities allotted to that company with a calculation showing the amount of the claim, principal and interest, to January 1, 1939, which was the date of the plan, exceeded by approximately three and a half million dollars the securities received by that claimant, giving to the bonds and preferred stock that claimant received, par value, and assigning to the common stock that claimant received the value of $62 a share, which was assigned to the stock in the Interstate Commerce Commission plan. And I should like to offer this as being identified as a single sheet which I have described, as our computation, numbered Defendant's Exhibit No. 33, and I will hand copies to counsel upon the understanding that counsel, of course can check and correct if they should find any errors or inaccuracy in the statement that I offer. [1053]

Mr. Phleger: May it please the Court, this is simply a computation. The material is in the record. I suggest that it is proper material to be included in their brief, not a matter of proof at all.

Mr. Clark: Or in the form of a memorandum simply handed up to your Honor, but not an exhibit. It is all in the record.

Mr. Adams: It would be a matter of convenience to the Court. I suppose that is why I handed it in.

The Court: You have these summaries in already, which perhaps is not altogether proper evidence, but it may be admitted as a computation subject to correction.

(The computation referred to was received in evidence and marked Defendants' Exhibit 33.) [1054]

* * *

May I call Mr. Ehrman.

SIDNEY M. EHRMAN

called on behalf of the defendants; sworn.

The Clerk: Will you state your name to the Court.

The Witness: Sidney M. Ehrman.

* * *

Direct Examination

By Mr. Adams:

Q. Mr. Ehrman, you are a resident of San Francisco and you are the senior member of the attorneys' firm of Heller, Ehrman, White & McAuliffe? A. Yes.

Mr. Adams: If you will pardon my going ahead with this rather rapidly, I think perhaps I can save time, your Honor, in stating what I have in mind by way of leading questions on this subject.

The Court: All right.

(Testimony of Sidney M. Ehrman.)

Q. (By Mr. Adams): How long have you been engaged in law practice, Mr. Ehrman?

The Court: Why don't you make a general statement?

Mr. Adams: Very well, I shall, your Honor.

The Court: Just state what you want to show.

Mr. Adams: Mr. Ehrman has been engaged in the law practice since 1897. He has been a director of numerous corporations, including banking and financial institutions, and has frequently dealt with business and financial matters, reorganizations and the like. He has served for many years on the finance committee of the Board of Regents of the University of California. In the course of his practice he has had occasion to consider the effect of taxes upon corporate and business transactions, and I might ask Mr. Ehrman this question:

Q. How frequently would you say that you consider such tax [1057] effects?

A. I should say in the last twenty years particularly, and before that, the tax effects would have to be weighed in almost every corporate matter that was under consideration where money was involved, and particularly in the matter of consolidations and mergers and other corporate procedures of a like nature.

Mr. Adams: May I add this further, your Honor: Mr. Ehrman has been a director of the California State Chamber of Commerce for ten years, and during the same period chairman of

(Testimony of Sidney M. Ehrman.)

the statewide Tax Committee of the California State Chamber of Commerce. He was one of the reorganization trustees in the reorganization of the Western Pacific Railroad Company, serving as such from his appointment, November 9, 1935, until his discharge, May 21, 1945, and he and his co-trustee, Mr. Schumacher, during that period had charge of the operation of the railroad until the end of 1944, when the railroad property was reconveyed to the reorganized railroad company.

Q. And it is the fact, is it not, Mr. Ehrman, that during that time Charles Elsey as the trustees' agent selected by the court was in direct charge of the operation of the railroad under the trustees?

A. That is correct.

Q. Did you seek appointment, Mr. Ehrman, as reorganization trustee of the Western Pacific Railroad Company? A. No, I did not. [1058]

Q. Who first suggested to you that you become one of the trustees?

A. His Honor Judge St. Sure.

The Court: I was just going to answer that question for you. I happen to know about that, not at the time, but Judge St. Sure told me about it. Judge St. Sure did not care very much about Mr. Ehrman, so that is why he appointed him.

Is that right?

The Witness: Yes. When I came to the office a little after nine o'clock I had a message there that Judge St. Sure wanted to see me. As a mat-

(Testimony of Sidney M. Ehrman.)

ter of fact, I inquired around whether anything was wrong with any cases we had pending before Judge St. Sure. I hadn't the slightest notion that a petition had been filed by the Western Pacific Railroad Company. He sent for me and then he told me he would like me to act as one of the trustees; Mr. Schumacher would be the other. That is the first I knew about it, and that is how it came about.

Mr. Adams: Your Honor, may I also ask counsel to follow these statements I am about to make about Mr. Ehrman's financial disinterest in the Western Pacific:

At no time during his trusteeship did he have any financial interest in the Western Pacific Railroad Company or any of its subsidiaries. Mrs. Ehrman had some Western Pacific bonds, but she sold those at the time he became a trustee. At no time during his trusteeship did he have any financial interest in the [1059] Western Pacific Railroad Corporation. At no time during his trusteeship did he have any financial interest in the Metropolitan Life Insurance Company, the Prudential Life Insurance Company, the Chase National Bank of New York, or the Central Hanover Bank. At no time during his trusteeship did he have any financial interest in the A. C. James Company or the Curtis Southwestern Corporation or Company or any company of Arthur Curtis James or any financial interest in the business or investment affairs

(Testimony of Sidney M. Ehrman.)

of Mr. James or the James Foundation of New York, Inc. At no time during the trusteeship did he or his firm at any time represent or act as attorneys for any of the companies I have named or for Arthur Curtis James. At no time during the trusteeship did Mr. Ehrman at any time have any personal interest, financial or otherwise, in any matter or transaction with which he dealt as trustee or any interest or representation in such matters other than the performance of his duties as trustee.

I take it that is all agreeable to counsel?

Mr. Clark: It is conceded.

Mr. Phleger: Yes.

Q. (By Mr. Adams): Mr. Ehrman, throughout your trusteeship did you exercise your independent judgment regarding all matters with which you dealt as trustee? A. I did.

Mr. Adams: May I read further, your Honor, and I will tell [1060] counsel the next point, that is, Mr. Ehrman's non-participation with respect to the plan of reorganization. I will read this briefly. At the beginning Mr. Ehrman made some suggestions to Mr. Schumacher regarding provisions of the original debtor's plan. Thereafter he had nothing to do with the plan of reorganization or plans of reorganization. Perhaps I should ask these questions of the witness.

Q. Did you consider, Mr. Ehrman, that as trustee you were concerned or not with the formulation of the plan?

(Testimony of Sidney M. Ehrman.)

A. I did not think the trustees had anything to do with that; not concerned with it.

Q. Did you consider that the trustees were concerned with the rights of claimants to participation under the plan?

A. I did not quite get that question.

Q. Did you consider that the trustees were concerned with the rights of claimants to participation under the plan? A. No, I did not.

Q. Did you at any time ever take any position as to the rights of any claimants?

A. Not at all. The trustees always tried to maintain an absolutely neutral position.

Q. Mr. Ehrman, who was in the control of the railroad's property and business during the period of trusteeship from November 9, 1935, to the end of 1944?

A. I should say the Court was in control represented by the [1061] trustees.

Q. And to whom did the trustees look for the direction of their conduct as trustees throughout this period? A. The Court.

Q. To whom did they look for advice with regard to business matters in their charge?

A. Mr. Elsey was the agent for operation, and they consulted with him. I do not think they looked for advice on conclusions that were reached. They made their own conclusions.

Q. To whom did the trustees look for advice on legal matters?

(Testimony of Sidney M. Ehrman.)

A. In the first instance to Warren Olney, Judge Warren Olney, Jr., who represented the trustees, and after his death to Mr. Allan Matthew, both of them appointed by the Court.

Q. Mr. Ehrman, will you tell the Court generally what work you did as trustee.

A. Well, I covered a rather wide range. I was in touch with Mr. Elsey, who was operating the railroad, constantly. I suppose I saw him on an average maybe twice a week. I telephoned to him four or five times a week asking him about things. That involved, of course, the reconstruction of the road and a great many details connected with that; the purchase of equipment from time to time, and practically all matters concerned, at least from a statistical standpoint, with the operation of the railroad. I was not an operating man. I would not know how to operate a railroad except on paper. But I kept in touch [1062] with what was being done. In the early part of the reorganization I devoted myself particularly to the financial side of the matter. We had to get money to rebuild that road and we had to issue trustees certificates, and the question was how to sell them and where to sell them and to whom, and I concerned myself with that particularly. I went to New York on it, I think two or three years, when they were sold, and had to be sold over again to new purchasers, until finally Mr. Jones made an agreement with us, with the Reconstruction Finance Corporation,

(Testimony of Sidney M. Ehrman.)

and took over the outstanding certificates, and it continued that way until the end of the trusteeship, although we paid him down some $7,000,000, I think—$6,000,000 first, and I think we gave him an extra million afterwards. We could have paid him off, but he wouldn't take it because he had a contract for the bonds.

Q. Mr. Ehrman, did the trustees operate the subsidiary properties, such as the Sacramento Northern and the Tidewater Southern, as a part of the railroad system?

A. I think all of those subsidiaries of the railroad company were included. They were operated, I know, and I spent some time particularly, I think, in considering the Sacramento Northern Railroad. At one time in the beginning of the trusteeship we were seriously considering ceasing operation, particularly passenger operation, and also abandoning parts of the road that were already pretty thoroughly served by the Western [1063] Pacific Railroad. No action, however, was ever taken in that respect, and of course when the war came on there was occasion to use the Sacramento Northern constantly. It was a great help.

Q. Will you state, please, to the Court generally the nature and scope of your contacts with the bankruptcy judge, Judge St. Sure, during the reorganization.

A. I saw Judge St. Sure very frequently during the reorganization, not only when proceedings took place in his court, but at the lunch hour. I

(Testimony of Sidney M. Ehrman.)

felt that I always wanted to report to him what was going on. He was very interested in knowing what was going on, and I wanted him at least to give an assent or not dissent from some of the things we were doing in the operation of the road, spending a good deal of money, and I felt the responsibility and I wanted the Court to know it.

Q. Do you recall any expressions on the part of Judge St. Sure regarding the services of your co-trustee, Mr. Schumacher?

A. Do I recall what? I did not quite get the question.

Q. Do you recall any expressions on the part of the bankruptcy court, Judge St. Sure——

Mr. Clark: We will object to that on the ground it is incompetent, irrelevant and immaterial to any issue in this case. [1064]

The Court: Well, ask him that question. [1068]

The Witness: Did Judge St. Sure know about it? Yes, he knew that we continued the employment of Mr. Nicodemus and his firm, Pierce & Greer, which had existed before the bankruptcy was filed, before the proceeding was filed.

Q. (By Mr. Adams): Now, Mr. Ehrman, there is in the record of this proceeding now paper memoranda showing that in June, 1943, the trustees assumed the whole expense of the New York office from that time forward. Was Judge St. Sure informed of those arrangements at or about that time? A. Yes, I informed him about it.

(Testimony of Sidney M. Ehrman.)

Q. Did he express any disapproval of that arrangement?

A. No. He asked me whether it was necessary to continue the New York office. I said I thought it was necessary for the time being, at least, but the trusteeship would probably wind up within a year, and at that time I thought it advisable to let things stay as they were and let the new company that was going to take over, or the reorganized company, decide what they wanted to do about that.

Q. Now, Mr. Ehrman, were you personally acquainted with Mr. Schumacher before the beginning of the trusteeship?

A. I had met Mr. Schumacher, but not intimately at all. I met him out here when he was working for the Southern Pacific Company.

Q. Did you know his reputation in the railroad industry at the time he was appointed trustee?

A. Yes. He was supposed to be a very experienced railroad man. He had served in many capacities in the Southern Pacific, also in the Western Pacific, and the other James road, the El Paso Southwestern, I think is the name of it.

Q. Now, were your relations with Mr. Schumacher during the trusteeship satisfactory?

A. Entirely so. [1069-A]

Q. Did you form any impression as to his personal disinterestedness and independence of judgment in his conduct as trustee?

(Testimony of Sidney M. Ehrman.)

Mr. Clark: We object to that, may it please your Honor, on the ground it is incompetent, irrelevant and immaterial and calls for the opinion of this witness. There is nothing factual about it.

The Court: I think that is right.

Mr. Adams: Objection sustained, I take it, your Honor?

The Court: Yes.

Q. (By Mr. Adams): And you know, I take it, Mr. Ehrman, that the Western Pacific Railroad Corporation owned all of the stock of the debtor company? A. Yes.

Q. What was your understanding of the function of the New York office of which you spoke a moment ago?

A. The New York office—you mean during the trusteeship?

Q. Yes, precisely.

A. Well, they received copies of all correspondence that was going on. Mr. Schumacher kept his records there, of course. They also attended to freight matters, freight claims and business of that sort. Of course the office was used for interviewing people. When I was east on several occasions I used the office as much as a month at a time—had my office there. And I talked with a good many of those banking investment houses. I would make appointments there for them, sometimes I would go there and [1070] meet them at their place, talking about the sale of trustee certificates, the issuance, rates, all the details. Also equipment trust

(Testimony of Sidney M. Ehrman.)

certificates were issued by the trustees, and the place was used generally as an office. It was used with the Western Pacific Railroad Corporation. They had half of it, they paid half the expense of operating it.

Mr. Adams: Would it be a convenient time, your Honor, to take a short recess?

The Court: Very well, we will take a recess at this time.

(Recess.)

Mr. Adams: Mr. Ehrman, do you recall that in the spring of 1943, the trustees engaged tax counsel? A. Yes, sir.

Q. What was your reason for employing tax counsel at that time?

A. Well, I think that the reason was because matters had grown a little more complex on account of the large earnings that the company was making, and there were considerations for changing over some methods of accounting, and instead of just having our accountants handle it, we thought there ought to be tax counsel.

Q. And whom did the trustees engage?

A. Specifically, Mr. Polk was the man who was in charge. It was the firm, I think, of Whitman, Ransom, Coulson and Goetz.

Q. Did you consider the firm as suitable for the purpose? A. Yes.

Q. And you have said you learned that Mr. Polk

(Testimony of Sidney M. Ehrman.)

was to do the [1071] work. What was your understanding as to his qualifications?

A. I understood he was highly qualified, because I had heard that he had been connected with the Treasury Department, had had experience with the government, and I heard that he had been very successful in handling some most important tax matters for the Consolidated Edison Company and New York, and some other matters, too; that he was very experienced in tax matters.

Q. Now do you recall, Mr. Ehrman, a trip that Mr. Schumacher made to San Francisco in June of 1943? A. Yes.

Q. And an occasion when you met him in Salt Lake on the annual inspection trip? A. Yes.

Q. And that was an inspection trip on which Mr. Elsey and Judge St. Sure and others were traveling, in the annual inspection?

A. In that year, I think it was '43, Judge St. Sure went more than once—but I am quite sure that was the year that he did go, and when we all met at Salt Lake.

Q. Now referring to the time when Mr. Schumacher was here in San Francisco, do you have any recollection of the discussion with regard to the possible use of the corporation's stock loss in the railroad company as an offset to the trustees' taxable income?

A. I don't remember just when that was. I can't place it. But it may have been in June that

(Testimony of Sidney M. Ehrman.)

that was mentioned. It was merely [1072] mentioned; there was no talk about it. But there was a possibility. In other words, I place it some time before the date when we went to court to get authority, and it was definitely determined. There was talk about it, that there was a possibility. Now whether that was in June or some time later that I talked with Mr. Elsey or Mr. Schumacher, I couldn't say. I don't think I could have talked with him until he came out again the next year. But I have a recollection that it wasn't a new matter when I heard it at the time. It was definitely determined upon. Somebody had mentioned to me the possibility that it could be done.

Q. You do have in mind in giving your answer that it was in January of 1944 that that matter was again taken up with you?

A. Yes, it was then definitely. We had been advised by Mr. Polk of the Whitman firm that in their opinion there was a good possibility of a return of that kind being accepted by the Treasury Department.

Q. Now in that connection, Mr. Ehrman, did you give consideration to the establishment of a reserve for contingent tax liability? A. Yes.

Q. And with whom did you discuss that subject?

A. Well, I discussed it with Mr. Elsey and Mr. Matthew—no, I think Mr. Schumaher's was by correspondence. It may have been on the telephone, because I telephoned him on occasions, talked these things over.

(Testimony of Sidney M. Ehrman.)

Q. Now did you have an understanding at that time that tax accruals—that is, the income tax accruals for the year 1943—had been reversed?

Mr. Clark: May I ask, your Honor, what time this is directed toward?

Q. (By Mr. Adams): I am speaking now of the beginning of 1944, are we not, Mr. Ehrman?

A. I understood that that was the period that you last referred to.

Q. And I was directing your attention to the question of your understanding about the fact that the accruals that had been carried on the books for tax liability were reversed, and I was asking you if you had a recollection about that.

A. Well, I think so, but I am not entirely clear.

Q. Now you do have in mind this matter of the reserve to be set up for contingent tax liability?

A. Pardon me, I didn't quite get that. Would you read that, Mr. Reporter?

(Question read.)

A. Yes.

Q. And what was the reason for setting up the reserve, Mr. Ehrman?

A. Well, the reason was that if the government or the Treasury Department refused to accept the theory on which the return was [1074] to be made, mainly, that the losses incurred by the Western Pacific Railroad Corporation could be offset against

(Testimony of Sidney M. Ehrman.)

the gains made by the railroad company or the gains could offset the losses, there wouldn't be the tax.

Q. And at that time did you know, Mr. Ehrman, what the principal loss was that would enter into those returns? A. Yes.

Q. And what was that?

A. That was the loss of the value of the stock of the railroad company.

Q. And whose loss was it?

A. That was the corporation's loss, the Western Pacific Railroad Corporation's.

Q. Now did you understand at that time that any particular kind of return would have to be filed in order to have this loss offset the trustees' income?

A. Yes, it had to be a consolidated.

Q. And filed by what company?

A. By the corporation.

Q. When you say the "corporation," you mean the parent company?

A. The parent company. It had been filed that way right through the trusteeship.

Q. Now you have referred to Mr. Polk's opinion; that was the opinion concerning which you stated he said it was proper to claim that loss in the tax return for '43. Did you rely on his [1075] opinion? A. Yes.

Mr. Clark: Well, does the question refer to the written opinion which is in evidence, may it please your Honor?

(Testimony of Sidney M. Ehrman.)

Mr. Adams: That is plaintiff's exhibit 11, is it?

Mr. Clark: 54.

Mr. Adams: Oh then, I have the wrong paper in mind. Let us look at plaintiff's exhibit 54.

Mr. Clark: Yes, plaintiff's 54 is the original opinion.

(Document handed to Mr. Adams by the Clerk.)

Mr. Adams: And will counsel agree that a print copy of plaintiff's 54, the opinion of January 11, 1944, is contained in the files of Mr. Ehrman, as one of the trustees in reorganization?

Mr. Clark: I will so agree; with the further concession or qualification that Mr. Ehrman received his copy on or about January 24, 1944, as demonstrated by the evidence taken on deposition. Will you accept that?

Mr. Adams: Yes, that is correct; that is my understanding of the matter. That is a correct statement.

Mr. Clark: Very well.

Mr. Phleger: And further, that the letter was signed by Mr. Coulson and not by Mr. Polk.

Mr. Adams: Well, Mr. Ehrman's file copy will only show the firm name.

Mr. Phleger: Well, you have been referring to it as the [1076] "Polk opinion." It was Mr. Coulson's letter.

Mr. Adams: I think you carry it a little too far,

(Testimony of Sidney M. Ehrman.)

but I agree that the signature of the firm name is Mr. Coulson's signature.

Mr. Phleger: That is the point.

Mr. Adams: That is right. (Handing document to witness.)

The Court: I don't think you have any questions now.

Mr. Adams: No, I am waiting for Mr. Ehrman to look at the document.

The Witness: You want me to look at this?

Q. (By Mr. Adams): Mr. Ehrman, look at it as far as need be to answer this question, please: Is this the opinion that you referred to in your answers when you spoke of relying on Mr. Polk's opinion? I am referring, for the record, to plaintiff's exhibit 54.

A. Well, when you asked me about relying on the opinion, I knew there was an opinion. I knew that I had some opinion in my file. I had forgotten about it until I discovered it on the taking of my deposition, that it was there. But I don't recall that I saw this particular document. Mr. Elsey or Mr. Matthew both told me that the opinion had been given by our tax counsel, and I accepted that.

Q. Mr. Ehrman, the record shows, and we have just stipulated, that there is in your files a print copy of that document you have in your hand, and that it was received by you on or about [1077] January 24, 1944, as an inclosure in a letter Mr. Elsey wrote you at that time. A. Yes.

(Testimony of Sidney M. Ehrman.)

Q. I am showing you that because we have all seen the record. Now with that in mind, would you say that that was the opinion you had reference to?

A. Well, that is the opinion. I think that is the only opinion, as far as I know, that was written by that firm on that subject.

Q. At or about that time?

A. At or about that time.

Q. Thank you, sir. Now, Mr. Ehrman, did it ever occur to you that if the government should allow these returns with the holding company's loss set off against the trustees' income, the holding company would have any claim against the trustees?

Mr. Clark: Object to that on the ground it is incompetent, irrelevant and immaterial.

Mr. Adams: Your Honor, as I said in my opining statement, this claim now before your Honor is an afterthought, and this is a part of the proof of that defense.

The Court: Well, what is the connection between those two statements; the fact that Mr. Ehrman didn't think of, or it didn't occur to Mr. Ehrman, wouldn't have anything to do with whether it was an afterthough of the plaintiff.

Mr. Adams: The fact that it didn't occur to Mr. Ehrman is significant, Your Honor, because had it occurred to either of [1078] the trustees, then the obvious question next would arise, they certainly

(Testimony of Sidney M. Ehrman.)

would have taken it before Judge St. Sure. Now these gentlemen were not acting in a position adverse to the corporation. They were acting as trustees of the court. And in our view, it is part of our defense. [1078A]

The Court: Would the plaintiff be bound by any thoughts or action or inaction on the part of the trustees at all? Assume that they did not consider that there was any obligation on the part of the plaintiff and they proceeded on that ground; it still would not make any difference on the question whether the plaintiff had a right to pursue what it claims as its claim in the case.

Mr. Adams: I am seeking, your Honor, to meet a claim here presented in behalf of our adversaries that the trustees and their lawyers, with no malign or improper purpose, took something of the plaintiff corporation.

The Court: But how Mr. Ehrman as one of the trustees regarded the acts that were done would not have any materiality.

Mr. Adams: I am seeking to show, your Honor, that if by any conception the trustees took—and that is an active performance—anything belonging to these people, they were wholly unaware of it. That is the purpose of this question.

Mr. Phleger: We will so stipulate. We will so stipulate.

Mr. Adams: As regards all parties acting on behalf of the defendant?

(Testimony of Sidney M. Ehrman.)

Mr. Phleger: We will stipulate that Mr. Ehrman did not have any idea of any claim.

Mr. Adams: The stipulation will be acceptable.

Mr. Phleger: I make the further stipulation that he never thought about the subject. I ask you to stipulate to [1079] that, Mr. Adams; not that it did not occur to him, but he never thought about it.

Mr. Adams: I will stipulate that the idea never came to him in anyway, shape or form.

Mr. Phleger: All right.

Mr. Adams: This notion that the corporation could have a claim of the sort now presented in this court never occurred to Mr. Ehrman at any time until after he heard that a lawsuit had been brought in which the claim was asserted, and I take it we are on common ground.

Mr. Phleger: I asked you to stipulate that he never thought on the subject, thought about it at all. Will you so stipulate?

Mr. Adams: I think what I have said is the same thing. How can one think about something which has never occurred to him?

Mr. Phleger: If it is the same thing you will so stipulate, will you not, Mr. Adams?

Mr. Adams: According to my own statement that they amount to the same thing. May I have the same stipulation from the interveners?

Mr. Clark: Certainly.

Mr. Adams: Then certainly the question should be unnecessary, your Honor.

(Testimony of Sidney M. Ehrman.)

Mr. Phleger: And all further questioning of the witness [1080] is unnecessary.

Mr. Adams: Let me see about that. I have not read all my questions yet. I think I can ask this one:

Q. Did anyone ever suggest to you that such a claim might exist?

Do you want to stipulate that no one ever suggested such an idea to Mr. Ehrman?

Mr. Phleger: He is a very bright man and I am sure if they suggested it to him he would know something about it.

Mr. Adams: Then I take it that it is agreed no such suggestion was ever made to Mr. Ehrman prior to the time he heard about this litigation by anyone.

The Court: You have a broader agreement than that already. The idea never occurred to him.

Q. (By Mr. Adams): It was your understanding, Mr. Ehrman, at the time that the holding company was to file a consolidated return, including the stock loss? A. Yes.

Q. What was your understanding as to who would pay the taxes if any should be assessed?

A. Well, I knew the Western Pacific Railroad Company would have to pay them, because I was told by Mr. Schumacher—that is hearsay—but anyway, I found out as a matter of fact that the Western Pacific Railroad Corporation could not even pay the expenses, the expenses of operating the New

(Testimony of Sidney M. Ehrman.)

York office, so it did [1081] not have funds with which to pay.

The Court: Irrespective of that, of course, the railroad company would have to pay it. It was their income.

Mr. Adams: I think that is right, your Honor. That is our position.

The Court: It would not make any difference what the understanding of anyone was concerning it.

Mr. Adams: The statute prescribes a joint and several liability, but I have no doubt that the parties who would have to pay that tax were those who had the income.

Q. Mr. Ehrman, referring to the taking over of the expenses of the New York office in June of 1943, did you approve of that? A. Yes.

Q. What was your reason for approving it?

A. Well, I approved that because I thought it was to some extent a necessary part of the railroad's operation at that time. Mr. Schumacher felt that he wanted it there, wanted the people who were in that office to continue the functions that they were doing for him as trustee, and in any event there was a short duration expected for the trusteeship and the people who were to follow, the reorganized company, could make up its mind then whether it wanted the office or not.

Q. Do you recall a discussion that you had in San Francisco about that subject?

A. Yes, there was a meeting on that. [1082]

(Testimony of Sidney M. Ehrman.)

Q. Who were the parties at that meeting, as far as you recall?

A. Mr. Schumacher, Mr. Elsey, Mr. Matthew and myself.

Q. In the course of that discussion, Mr. Ehrman, was that matter of taking over the expenses of the New York office in any way related to the income tax problems of the trustees?

Mr. Clark: Will you please fix the time of the discussion?

Mr. Adams: In June of 1943.

The Witness: No, that was something quite different.

Mr. Adams: I have no further questions, your Honor.

Mr. Phleger: I have no questions.

The Court: Any questions?

Mr. Clark: Yes, we have a few, your Honor.

Cross-Examination by Interveners

By Mr. Clark:

Q. Mr. Ehrman, have you ever specialized in income and excess profits tax law, Federal law?

A. Personally I never specialized.

Q. Particularly have you ever specialized in the matter of filing consolidated returns on the part of corporations? A. No, no, I did not.

Q. In connection with the consolidated return to be filed by the plaintiff corporation for the year 1943, did you personally discuss that matter with Mr. Polk? A. No.

(Testimony of Sidney M. Ehrman.)

Q. At that time had you ever even met Mr. Polk?

A. To the best of my recollection I only met Mr. Polk once in [1083] my life and that was very casually as he was coming from lunch with Mr. Elsey and Mr. Matthew, I believe, and I was coming from lunch in the Palace Hotel; we happened to meet and I was introduced to Mr. Polk.

Q. But you did not discuss the tax matter with which we are involved here with Mr. Polk at all?

A. I have no recollection of it.

Q. When you say that you relied upon your tax counsel in connnection with that matter, do you refer to this opinion that was called to your attention?

A. Yes. Early in the year 1943, I think—it was probably right after, it may have been before the Supreme Court handed down its decision in this Western Pacific case—this matter of having tax counsel taken up, and I was satisfied with it.

Q. From that time on did you rely upon this tax counsel for all tax matters pertaining to the trusteeship? A. Yes, sir.

Q. In January 1944, Mr. Ehrman, when you agreed to the tax procedure, it was then explained to you—I think you said by Mr. Elsey or Mr. Matthew possibly—did you at that time know whether or not that procedure had been submitted to the directors of the plaintiff corporation?

A. No, I did not know.

Q. Did you give that matter any thought at all?

A. No, I did not give it any thought. [1084]

(Testimony of Sidney M. Ehrman.)

Q. Did you give any thought to whether or not the plaintiff corporation had advice other than the Whitman firm with respect to those matters?

A. I never considered that at all.

Q. At any time, Mr. Ehrman, were you ever advised of the mechanics by which the 1943 return was ultimately filed, that is, who signed it, et cetera?

A. Well, I did not know who signed it. I knew it would have to be signed by the proper officers or some proper officer of the Western Pacific Railroad corporation.

Q. After the reserve fund was finally set up, which the record shows was on March 3, 1944, did you pay any further attention at all to that tax matter?

A. No. I knew of it, but I paid no attention.

Q. There has been put in evidence in this case a refund claim dated March 9, 1945, which was called to your attention on deposition. Do you remember about that?

A. I remember the fact that there was a refund claim put in, but I do not remember any details about it. I did not really concern myself with the tax situation as far as the railroad was concerned.

Q. Were you ever consulted at any time with respect to whether or not a refund claim should be filed?

A. I have no memory of it now, but I would not be a bit surprised——

(Testimony of Sidney M. Ehrman.)

Q. Directing your attention to the date March 9, 1945—— [1085]

Mr. MacKinnon: I submit that the witness should be permitted to answer the question. When he is attempting to answer a question he is interrupted right in the middle of his answer.

Mr. Clark: I merely wanted to call his attention to the date, March 9, 1945. That is the date of the refund claim.

The Witness: That does not ring any bell as far as my recollection is concerned, but I think I heard of the matter, knew that such a refund was to be filed or had been filed. I have some memory of it, but no particular memory of the details or the occasion. That was a refund for 1942, wasn't it?

Mr. Clark: Yes.

A. I know there was such a refund, and I think there was some settlement finally made, when it was finally settled with the Government; they paid something on that year. There was an offset, but whether I heard of that later or not, I do not know.

Q. That was long after the termination of the trusteeship?

A. Long after I was out of office.

Mr. Clark: That is all, your Honor.

The Court: Any other questions?

Mr. Adams: No further questions, your Honor.

The Court: That is all.

Mr. Phleger: Might I direct the Court's attention to a colloquy which occurred with Mr. Adams,

(Testimony of Sidney M. Ehrman.)

and I do not know that you got the significance of it. It is a fact, Mr. Adams, you will stipulate, that when consolidated returns are filed, all [1086] the parties, including the parent corporation, are liable for the entire tax?

The Court: I understand. That is payable to the Government.

Mr. Phleger: That is right.

The Court: As between parties, obviously the person or the company who had the income would have to pay the taxes.

Mr. Phleger: Right.

The Court: May I call Mr. Elsey?

CHARLES ELSEY

called as a witness on behalf of the defendant, sworn.

The Clerk: Will you state your name to the Court?

A. Charles Elsey.

Direct Examination

By Mr. Adams:

Q. Mr. Elsey, at this time are you an officer or director of the Western Pacific Railroad Company?

A. No.

Q. When did you retire?

A. December 31, 1948.

Q. Prior to that time, what offices have you held with the Western Pacific Railroad Company?

(Testimony of Charles Elsey.)

A. I was director and president.

Q. You are speaking now of the reorganized concern that came out of the court on January 1, 1945? A. Yes, sir.

Q. Do you now receive compensation from the company under a retirement plan?

A. I have been advised that the Board of Directors has passed on my pension.

Q. Will you please state to the court the offices which you have held with the Western Pacific Railroad Company, the old company, beginning December, 1907, if that is the date of the beginning, and run through it for the record. [1087]

A. I was elected assistant treasurer of the Western Pacific Railway Company on December 3, 1907, and continued in that office until September 10, 1908. On September 10, 1908, I was elected treasurer and held that office until October 10, 1916. On October 10, 1916, I was elected treasurer of the Western Pacific Railroad Company and held that office to February 24, 1920. I was elected a director on January 8, 1917. I was elected secretary-treasurer on October 24, 1920, and held that office until November 14, 1921. On November 14, 1921, I was elected vice-president in charge of finance, accounting, real estate and insurance. I held that office until May 29, 1929.

On May 29, 1929, I was elected vice-president to discharge the duties of the president in his absence. I held that position until September 3, 1929. On

(Testimony of Charles Elsey.)

September 3, 1929, I was elected executive vice-president and held that office until December 31, 1931.

On January 1, 1932, I was elected president. On November 9, 1935, I was appointed by Judge St. Sure as the managing agent for the reorganization trustees and I held that position until December 31, 1944.

I was elected president of the reorganized company on January 1, 1945, and held that position until December 31, 1948.

Q. Mr. Elsey, have you at any time been an officer or director or held any position with the Western Pacific Railroad Corporation? [1088]

A. No, sir.

Q. During the period prior to the beginning of the reorganization proceedings, by whom were the directors and officers of the Western Pacific Railroad Company chosen?

A. By the Western Pacific Railroad Corporation, the holding company.

Q. Referring to the period of trusteeship, what in general did you understand your responsibilities to be as the managing agent for the trustees?

A. My understanding was that I was fully responsible for the management and operation of the property.

Q. To whom did you consider yourself to be responsible?

A. To the trustees and through the trustees to Judge St. Sure.

(Testimony of Charles Elsey.)

Q. To what extent were you in contact in general with Judge St. Sure during the period of trusteeship?

A. All of our contracts and leases which were to be entered into by the reorganization trustees were submitted to Judge St. Sure through a petition, and those petitions were notice for hearing and I appeared at practically all the hearings before the judge. We had a blanket authority to settle personal injury claims up to a thousand dollars. Anything in excess of a thousand dollars was sent to the judge through petition, and I testified on those matters. We had annual inspections over the property and Judge St. Sure, Mr. Ehrman and occasionally Mr. Schumacher, accompanied me on those trips. [1089]

At times I have discussed matters with Judge St. Sure in his chambers and also discussed various matters with Judge St. Sure and Mr. Ehrman at lunch. We prepared annual reports under my direction. Those reports were filed with the court with petitions. Petitions were noticed for hearing, and after hearing in court they were approved by the judge.

Q. How and to what extent, Mr. Elsey, did you keep the reorganization trustees informed during the period of reorganization?

A. I kept up a very extended correspondence with both Mr. Ehrman and Mr. Schumacher. I would call on Mr. Ehrman at his office and dis-

(Testimony of Charles Elsey.)

cuss various matters, secure their advice and authority on various problems that came up from day to day.

Q. To whom did you look for legal advice during the period of reorganization?

A. I looked for legal advice from the counsels that were appointed by Judge St. Sure. That was Judge Olney and after his death to Mr. Allan Matthew.

Q. Mr. Elsey, during the period of the trusteeship, to what extent were you engaged in discharging any corporate business—and by that I mean business of the Board of Directors—of the Western Pacific Railroad Company?

A. Very little. We had meetings of the board at various times and, of course, we had an annual meeting of our stockholders and issued annual reports, but I spent very little of my time on any corporate matters. [1090]

Q. During the period of trusteeship did you keep yourself informed regarding the business and affairs of the plaintiff corporation and holding company? A. No, sir, not at all.

Q. During the period of trusteeship did you keep yourself informed as to the changes that took place among the officers and directors of the holding company? A. No, sir.

Q. Did you have anything to do with formulating the plan of reorganization? A. No, sir.

Q. Did you have any interest or concern with

(Testimony of Charles Elsey.)

the distribution of securities to be issued by the reorganized company? A. No, sir.

Q. Or with the persons or interests to whom such securities would be issued? A. No, sir.

Q. Have you ever owned any bonds or stocks of any corporation in the Western Pacific group?

A. Yes.

Q. Please state what you have owned and when.

A. I purchased 100 shares of the common stock very shortly after the company came out of the hands of the reorganization. Other than that I own no stocks or bonds of any of the companies affiliated with the Wetsern Pacific. [1091]

Q. During this entire period of trusteeship, Mr. Elsey, is it the fact that you held no securities of either the railroad company or the plaintiff corporation or any other member of the affiliated group? A. That is correct.

Q. During this trusteeship what was your practice with respect to furnishing information when it was requested by parties to the reorganization proceeding?

A. We always furnished any information that was requested just as promptly and just as fully as we possibly could to them.

Q. When did you first become acquainted, Mr. Elsey, with Mr. Nicodemus of the firm of Pierce & Greer?

A. I would say some time during the year 1944.

Q. What relation at that time did you under-

(Testimony of Charles Elsey.)

stand existed between the firm of Pierce & Greer and the holding company?

A. He was their counsel.

Q. What was the relation at that time, according to your understanding, of the relation of the firm to the Western Pacfic Railroad Company?

A. He was the New York counsel.

Q. At that time did the railroad company in its San Francisco office have a law department of its own? A. Yes, sir.

Q. Was the law department continued after the appointment of the firm of Pierce & Greer? [1092]

A. Yes, sir.

Q. Did that firm have anything to do with the legal problems that were handled from the San Francisco office of the company? A. No, sir.

Q. How often did you see Mr. Nicodemus or his partner, Mr. Campbell?

A. Very occasionally, when I would make a trip to New York. There were times when Mr. Nicodemus came to San Francisco, but I can't recall of ever seeing Mr. Campbell. It is more than likely that I did, but I can't recall.

Q. How often would you say that you sought legal advice from Mr. Nicodemus or his firm?

A. Practically never.

Q. What was the relation, as far as you know it, of Mr. Nicodemus and his firm to the reorganization trustees during the period of trusteeship?

A. Mr. Schumacher requested that Mr. Nico-

(Testimony of Charles Elsey.)

demus be continued as New York counsel; various matters came up that he would like to have the advice of counsel on in New York, and we discussed that matter between Mr. Ehrman and Judge Olney and myself and we thought that Mr. Schumacher's request was reasonable.

Q. Now, Mr. Elsey, you were in court this morning when I was speaking with Mr. Ehrman about the taking over of the expense of the New York office? A. I didn't hear it. [1093]

Q. You recall a meeting held in your office in June, 1943, at which consideration was given to the taking over of the expenses of the New York office?

A. Yes.

Q. I see.

Mr. Adams: And may I have plaintiff's exhibit 28, please, Mr. Elkington?

(Document handed to counsel by the Clerk.)

Q. (By Mr. Adams): Mr. Elsey, I show you plaintiff's exhibit 28 in this case, being a memorandum for file dated June 2, 1943. This is a photostat (handing to witness). Is that photostat a photostatic copy of a record in the office, your office, as president of the Western Pacific Railroad Company during the period of trusteeship?

A. Yes, sir.

Q. Now does the memorandum enable you to fix the time of the meeting at which you say you discussed the taking over of the New York office expense? A. Yes, sir.

(Testimony of Charles Elsey.)

Q. And what is your recollection, as refreshed by this memorandum? A. June 2, 1943.

Q. Now do you have a recollection as to the discussion that took place at that meeting?

A. Yes, sir. [1094]

Q. Please state your best recollection of the discussion—strike that.

First, tell me, Mr. Elsey, who was present at the meeting?

A. Mr. Schumacher and Mr. Ehrman, Mr. Matthew and myself.

Q. And now please state your best recollection of the discussion.

A. Mr. Schumacher came out from New York and was very much concerned about the situation of being able to take care of the expenditures of the New York office. He stated that the holding company was without funds to meet their share of the expenses, and stated that it was very necessary for him to have an office in New York with the organization there to carry out his functions as one of the trustees of the company. And Mr. Ehrman and myself took the position that that request was a reasonable one.

Q. Was anything said at that meeting, so far as you can recall, with respect of the taxes?

A. No, sir.

Q. Was it your understanding that from that time on, Mr. Curry's entire compensation would be paid entirely by the trustees?

(Testimony of Charles Elsey.)

A. That is correct. [1095]

* * *

Q. (By Mr. Adams): Mr. Elsey, before the reorganization began, how were income tax matters handled in the Western Pacific organization?

A. Our general accounting department, which is headed by Mr. D. C. DeGraff, made up the figures for the Western Pacific and its subsidiaries, forwarded them on to New York to the office, the joint office of the holding company and the railroad company, and returns were completed and filed by the New York office.

Q. Throughout what period had this practice of filing the returns as prepared in the New York office been followed?

Mr. Clark: I object to it, may it please your Honor, as including the word "practice," which calls for the conclusion of this witness on a matter which may be of some importance in this case. I have no objection to the development of the facts as they occurred, but when it is described as "practice," that has the connotation that it was somewhat automatic. That point has been discussed before in this case.

Mr. Adams: I submit the question, your Honor.

The Court: Would you read that?

(Question read.) [1096]

Mr. Clark: I will withdraw that objection to that question.

The Court: All right. All right, Mr. Elsey, you may answer the question.

(Testimony of Charles Elsey.)

A. That practice was started in 1918 and continued up to practically the present date.

Q. (By Mr. Adams): What kind of returns were filed during that period?

A. Consolidated income tax returns.

Q. Who selected the officers and employees who prepared the returns?

A. The holding company.

Q. And were those officers and the employees joint officers and employees of the holding company and the railroad company?

A. Yes, sir.

Q. Who was the officer or employee that was directly in charge of the preparation of the returns? A. Mr. Curry.

Mr. Clark: Well, for whom, please?

Mr. Adams: May I proceed with my examination, your Honor?

Mr. Clark: Just a moment. I will object to that, may it please your Honor, upon the ground that it is indefinite. In his capacity as an officer of the company or as an officer of the corporation?

The Court: Well, you can cross-examine on that, counsel. [1097]

Mr. Clark: Very well, your Honor.

The Court: He simply asked for the name of the person. Overruled.

Q. (By Mr. Adams): Now, Mr. Elsey, do you know what practice was followed in regard to the allocation of the taxes between the members of the affiliated group? A. Yes, sir.

(Testimony of Charles Elsey.)

Mr. Phleger: Now, just a moment. I am going to object to any evidence now or hereafter as to what the tax practices were between these parties prior to these critical years, because in the critical years, a situation existed which had never theretofore existed; namely, the severance of the economic unity. They were divorced. They were separate companies. They were strangers, and it doesn't seem to me what their practice had been in previous years has the slightest bearing upon it.

Mr. Adams: Your Honor, may I respond to that argument?

The Court: Yes.

Mr. Clark: We will join in that objection, if the Court please. [1098]

* * *

Mr. Adams: I asked the question generally, over the whole period; of course, if there were some years when there wasn't any tax, that doesn't become involved and is not included in my question. My question was objected to, fundamentally, your Honor. Isn't it right, your Honor, that I should ask the witness about what was done about allocations of taxes? That is the question I put to him. Mr. MacKinnon gives me some help, and I will accept it. May I restate my question?

The Court: All right.

Mr. MacKinnon: Mr. Elsey, in the years during which taxes were paid, under these consolidated returns, what practice was followed in the allocation of the taxes?

(Testimony of Charles Elsey.)

Mr. Phleger: Just a moment. Now will counsel first state the years that he is talking about? Is he talking about '42, '43, '44? And secondly, I make my objection, as I say, upon a fundamental ground that this is irrelevant, incompetent and immaterial. I simply want the record to show it. If your Honor wants the evidence in—I think——

The Court: Well, counsel, I think that is a question I should decide when the case is decided, and not on a ruling on the form of the question.

Mr. Phleger: That is right; we simply want to put our objection. May it be deemed to run to any questions along this subject? [1110]

The Court: I think probably the best way to handle that would be to admit it, and then you can call my attention to it by motion to strike or by argument on the main case, because obviously this has some very definite and substantial bearing upon the defenses which the defendant is asserting, and if the evidence is competent and has weight, why, they are entitled to have it considered in their case.

Mr. Phleger: That is right, but we want simply to have the record show our objection on the grounds stated.

The Court: I think I shall overrule the objection as to materiality and competency of this line of examination, subject to a motion to strike in the ultimate disposition of the case.

Mr. Clark: May we add to the objection, your Honor, this: This witness hasn't been shown to be qualified to testify on the matter of tax allocation,

(Testimony of Charles Elsey.)

and it is not the best evidence—and that if, may it please your Honor, counsel would prepare a schedule of the facts, we possibly can all agree on it without getting the testimony second handedly through Mr. Elsey.

The Court: Well, if Mr. Adams won't object, I think I could reframe the question so as to avoid the difficulty about conclusions in the matter. I think that what you want to ask the witness, if I may suggest it, not as to what the practice was, but in the years in which the affiliated companies paid taxes, how did they divide the taxes?

Mr. Adams: Thank you, your Honor. [1111]

Q. Did you hear that, Mr. Elsey?

A. Yes, sir.

Q. Would you please answer that question?

A. The taxes was allocated among the various companies having a taxable income in proportion to their taxable income. These allocations were made in New York by Mr. Curry, and sent on to our general auditor in San Francisco.

Q. Now so far as you know, within the Western Pacific group, was payment ever made to any member of the group which reported a loss for the tax advantage which its loss conferred on other members of the group? A. No, sir.

Q. To your knowledge, was a suggestion ever made that any such payment should be made to a loss member of the group? A. No, sir.

Mr. Phleger: Well, now, I object to that; it seems to me——

(Testimony of Charles Elsey.)

The Court: That was, "Was any suggestion made"?

Mr. Adams: To his knowledge. I asked him if he knew of any such suggestion ever being made.

The Court: Well, of course that calls for a conversation. There is no foundation laid. I mean, that is too general a question. I will sustain the objection.

Mr. Adams: Very well, your Honor.

Q. Now, Mr. Elsey, after the reorganization trustees were appointed, was there any change in the manner in which the income [1112] tax returns were prepared?

A. No, sir, none whatever.

Q. Was there any change in the matter of the allocation of taxes? A. No, sir.

Mr. Phleger: Now just a moment; that assumes a fact which the evidence shows did not exist; there were no taxes from 1930 until 1942, and he is saying after the trustees were appointed, did they follow this practice of allocating taxes. There were no taxes.

Mr. Adams: Well, your Honor, there were such allocations handled by the trustees in respect of 1929, and of course there were allocations of the 1942 tax. With those two exceptions, I believe Mr. Phleger's statement is correct.

Mr. Phleger: The trustees came in 1935. So what happened in 1929 certainly didn't——

Mr. Adams: Oh, yes, it came before that particular time, that particular matter.

(Testimony of Charles Elsey.)

Mr. Clark: Not in '29.

Mr. Adams: Yes, the matter of the allocation of some taxes for '29. That is the way the Treasury works, many years late. That matter came before the trustees. However, I think the question has been answered, and it is subject to this colloquy, as I understand the record now.

The Court: Well, all right. [1113]

Mr. Adams: And just to clear this record for the benefit of all counsel, I will ask Mr. Elsey a question.

Q. Prior to the year 1942, was there any federal income tax paid by the reorganization trustees for any year during which they were operating the railroad properties? A. No, sir.

Q. Now, Mr. Elsey, what effect—strike that.

You have in mind that the railroad earnings for 1942 were very much greater than they had been in prior years? A. Yes, sir.

Q. And what was the principal reason for that?

A. The war traffic.

Q. Now during that year, did the accounting department of the railroad in San Francisco accrue taxes on those earnings?

A. Yes, sir, month by month.

Q. Did you have anything to do with determining the method of accrual? A. No, sir.

Q. Who had that in charge?

A. Mr. DeGraff, our general auditor.

(Testimony of Charles Elsey.)

Q. Do you know whether the accruals were made on a separate—strike that. [1114]

* * *

Q. Now, Mr. Elsey, speaking now of the accruals for 1942 taxes, do you know whether those accruals were made on the basis of a separate or a consolidated tax return? A. On a consolidated basis.

Q. And do you mean on a consolidated basis with or without the parent company?

A. With the parent company.

Q. Now do you recall that the trustees retained tax counsel to advise respecting the returns for the year 1942? A. Yes, sir.

Q. What were the circumstances that occasioned the employment of these tax counsel?

A. Our large increase in earnings, and the complex new tax law.

Q. And the name of the firm that was employed?

A. What is that?

Q. And the name of the firm that was employed?

A. Whitman, Ransom, Coulson and Goetz.

Q. Do you have any understanding as to who in the firm was to do the work as tax counsel? Did you have at that time?

A. Yes, Mr. Polk.

Q. And on whom did you rely for tax advice after the firm had been employed?

A. Mr. Polk. [1115]

Q. When did you first meet Mr. Polk?

A. June of '43.

(Testimony of Charles Elsey.)

Q. And do you know at whose suggestion he came to San Francisco at that time?

A. It is my best recollection he came to San Francisco at the request of Mr. Schumacher.

Q. Now at this time, Mr. Elsey, I show you Intervener's Exhibit 376.

Mr. Adams: This, your Honor, is a copy of the letter of May 20, 1943.

Mr. Clarke: 53, I think. Just a moment. 53 or 54.

Mr. Phleger: 53 is a letter of 1/8/44.

Mr. Clark: That is not the one.

Mr. Adams: I should have this, and I don't have it, your Honor.

Mr. MacKinnon: 50, Plaintiff's 50.

Mr. Phleger: Yes, that is the paradoxical letter, so-called.

The Court: This is Polk to Curry?

Mr. Adams: Yes, your Honor, that is the one.

Q. Plaintiff's 50 is the original of which this document, Interveners' No. 376, is a copy. And I will hand Interveners' Exhibit 376 to Mr. Elsey (handing to witness) and I ask you if that copy was produced from your files, as president of the railroad company and as agent for the trustees?

A. Yes, sir. [1116]

Q. Now, Mr. Elsey——

Mr. Adams: May the record show that, in referring to Interveners' 376, I am referring to a number assignable to the depositions, and not to the record in this case?

(Testimony of Charles Elsey.)

Mr. Clark: Well, it is a different paper, though, than Plaintiff's 50 in this case, is it not?

Mr. Adams: I have said that.

The Court: It is a copy.

Mr. Adams: Yes.

Q. Now, Mr. Elsey, directing your attention to the legend on page 1, "Recd.," meaning "received," from Mr. "T. M. S." at "S. F." with the "E"; is that Mr. Engelbright's notation? A. Yes.

Q. And who was Mr. Engelbright at that time?

A. My chief assistant in my office.

Mr. Adams: I will offer the document as Defendant's Exhibit 34.

Mr. Clark: No objection from us, your Honor.

Mr. Phleger: It is already in evidence, it seems to me. If they want to offer it as a copy, I suppose that would be all right.

Mr. Adams: That is right. May I see this? My purposes have been accomplished when I produced the fact that the copy of the letter containing that endorsement was in Mr. Elsey's files.

The Court: Well, you brought that out. That is a copy of Plaintiff's Exhibit No. 50. [1117]

Mr. Adams: If agreeable with all counsel, we need not encumber the record with a second copy of the paper, and I will therefore withdraw my offer of the document as an exhibit.

Q. Now, Mr. Elsey, following the time when you saw Mr. Polk in San Francisco in June, 1943, when did you next see him in connection with income tax matters? A. January of '44.

(Testimony of Charles Elsey.)

Q. And where did that meeting take place?

A. In my office in San Francisco.

Q. Now, you had a discussion at that time and place with Mr. Polk? A. Yes, sir.

Q. Will you please state the substance of your conversation with him at that time.

A. Well, Mr. Polk advised me that we were within our legal right in taking the corporation's stock loss as a deduction in our consolidated return. That loss far exceeded our income for that year. He also advised me that we should reverse our accruals for the entire year of '43. I was very much surprised at that statement and asked him if I could bank on it. He said No, that that matter will not be finally decided until the Treasury Department completes their audit on our '43 returns. I then stated to Mr. Polk that if that was a fact, I was going to ask the reorganization trustees to set up a reserve so that we would be protected in the event that the [1118] Treasury Department ruled out the tax loss. I then asked Mr. Polk to furnish me with his written opinion so I could use that opinion as a basis for my recommendations to the trustees, and Mr. Polk also advised me that all of us should be very careful about giving out any misstatements, as that would embarrass him when he had his dealings with the Treasury Department.

Mr. Clark: Now, may it please your Honor, may we have the date of this fixed as nearly as possible, the date of this conversation? I believe it is separable, the exact date, your Honor.

(Testimony of Charles Elsey.)

Q. (By Mr. Adams): Mr. Elsey, do you recall that you have a diary, an office diary?

A. Yes, sir.

The Court: What are you trying to find out, the date he had this——

Mr. Adams: Just the date, that is all.

The Court: How long before you got the opinion from him did you have the talk with Polk?

A. I got his opinion letter—it was either that afternoon or the following day, I think.

Q. Of the day that you had the conversation?

A. Yes, sir.

The Court: Now, does that establish it?

Mr. Adams: I don't think it establishes what we had in mind, what we were all talking about, your Honor. [1119]

Q. Mr. Elsey, the diary date of this talk with Mr. Polk was January 8, 1944, according to your best recollections? A. Yes, sir.

Q. Now, did you discuss the amount of the tax reserve with Mr. Polk? A. Yes, I did.

Q. And would you please state to the best of your recollection the time when you discussed that and what was said.

A. That discussion took place at the same meeting I had with Mr. Polk, and that the amount of the reserve should be an amount equal to what our taxes would be if the stock loss was disallowed.

Q. Now, what was your understanding at that

(Testimony of Charles Elsey.)

time as to how the taxes for 1943 had been accrued on the books of the railroad company?

A. On a consolidated basis.

Q. And when you say "a consolidated basis," do you mean with or without the parent company in the group?

A. With the parent company.

Q. Now, Mr. Elsey, do you recall the occasion on which you appeared in the reorganization court before Judge St. Sure and testified in respect of the application of the trustees for permission to set up a reserve fund for contingent tax liability?

A. Yes, sir.

Q. And that was on the 3rd of March, 1944, was it not? [1120] A. That is correct.

Q. Now, do you recall substantially the testimony that you gave before Judge St. Sure at that time? A. I do.

Q. And will you please state to the best of your recollection what testimony you gave before Judge St. Sure on that occasion?

Your Honor, before I end that question may I state that all counsel have looked for the transcript and we have not found the transcript.

Could you read the question, please?

Mr. Phleger: But we have found the very written document that he testified from, documents prepared by Mr. Matthew's associate.

Mr. Adams: I have it here in my hand.

(Testimony of Charles Elsey.)

Mr. Phleger: We have no objection to putting it in.

Mr. Adams: Well, is the same true as to other counsel?

Mr. Clark: Yes, indeed it is.

Mr. Adams: I have heretofore been admonished by counsel that I shouldn't show papers to the witness until it develops he cannot remember without them.

The Court: All right. Go ahead.

Q. (By Mr. Adams): Mr. Elsey,——

The Court: This is February 21?

Mr. Adams: This is March 3, 1944, the hearing on that petition of February 21. [1121]

The Court: Oh, yes.

Q. (By Mr. Adams): I show you a memorandum marked "Railroad Company Exhibit 914" on the depositions, and I ask you if this is the memorandum you had with you at the time you gave your testimony in court upon the hearing of that matter. A. Yes, it is.

Q. Did you testify substantially as set forth on pages 2 and following of the memorandum under the heading "Testimony"? A. Yes, sir, I did.

Mr. Adams: Any objection, counsel?

Mr. Phleger: No. We want you to stipulate——

Mr. Clark: No objection.

Mr. Phleger: We want you to stipulate, which is a fact, that the memoradum was prepared by Mr. Matthew's associate and handed to the witness and read from by him when he testified.

(Testimony of Charles Elsey.)

Mr. Adams: Well, I won't stipulate that he read from it; that is not the evidence. I will stipulate that the memorandum is one that was handed to Mr. Elsey in accordance with the standard practice between him and his counsel upon hearing of each matter, so that he would have in his hands a memorandum prior to coming to the hearing; that he studied the memoranda, that he used them in giving his testimony; that that is the case with regard to this one. Will you accept that?

Mr. Phleger: Certainly. [1122]

Mr. Adams: Very well. I offer the document, your Honor, as Defendants' Exhibit 34, being the same document heretofore marked Railroad Company Exhibit 914.

(The document referred to was received in evidence and marked Defendants' Exhibit 34.)

Mr. Adams: And I would like to read your Honor a portion of this memorandum, under the heading "Testimony." This is in the form of questions and answers:

"1. What would be the maximum Federal income and excess profits tax liability for the company if it filed a separate return for the year 1943, according to the computations of the company's accountants and tax advisers?

A. Approximately $7,000,000.

2. Please explain to the Court why it is believed no tax will be due under the consolidated

(Testimony of Charles Elsey.)

return method of reporting the income and losses of the several affiliated corporations.

A. Consolidated returns have been filed by the debtor company and its affiliated corporations for several years, as permitted by the Federal income and excess profits tax laws. During the calendar year 1943 certain members of the group have sustained very substantial losses, particularly the Western Pacific Railroad Corporation. That company [1123] sustained a very large loss when the stock of the debtor company owned by it became valueless upon confirmation of the Western Pacific reorganization plan in 1943. The aggregate losses of the affiliated corporations for the year 1943 more than offset the net income of the debtor company for the same year."

Then the next answer, or the question:

"Do you believe, however, it is prudent to establish a funded reserve to provide for the payment of any tax which might ultimately be found due?

A. Yes. I believe a funded reserve should be established for this purpose. Tax questions are seldom free from doubt. While we are confident of our conclusion in this instance, nevertheless, in view of the substantial amount here involved, the Internal Revenue Bureau may decide to litigate the matter. I think the debtor company should set aside out of 1943 earnings a sufficient amount so that it will be able to pay the highest possible tax which might conceivably be found due if the Commissioner should prevail in such litigation."

(Testimony of Charles Elsey.)

Then the next question is:

"What is the attitude of the trustees about the matter? [1124]

A. They have approved my recommendation that we establish a funded reserve of $7,100,000 out of 1943 earnings of the railroad of the debtor."

And the last question and answer relates to the investment of the monies.

Q. Now, Mr. Elsey, when you gave your testimony before Judge St. Sure that the amount of the reserve would be the amount computed as if the company were paying a separate return, was it your understanding at that time that that statement was correct? A. Yes, sir.

Q. According to your present understanding, was the statement correct?

A. No, sir, it was not.

Q. In what form would you now make the statement in order that it should be correct, in accordance with your present understanding?

A. I would state that the amount of taxes, or the amount of the reserve, rather, was based on the accrual of our taxes on the basis of a consolidated return with the Western Pacific Railroad Corporation, the reorganizaiton trustees and the affiliates.

Q. Now, when did you learn for the first time of the difference between your statement and what your present understanding of the matter is? [1125]

A. December of '48.

(Testimony of Charles Elsey.)

Mr. Phleger: I don't think he answered that earlier question at all.

The Court: It is not clear to me. I don't know what——

Mr. Adams: Let me hear the answer.

The Court: You asked him what kind of a reserve, or how he would set it up on the basis of what he now knows about it, and I don't know; I couldn't follow the answer. It didn't seem to me to be sequential to the question.

Mr. Adams: May I ask one or two more questions, then, your Honor, and see if we can clear that up?

The Court: Yes.

Q. (By Mr. Adams): Mr. Elsey, you have in mind that at the time you gave your testimony about how the amount of the reserve was fixed, you testified that it was fixed as an estimate of what the tax liability on a separate return basis would be?

A. Yes, sir.

Q. And that you thought that was a correct statement at that time? A. That is correct.

Q. And you learned since that that it was an error, or an erroneous statement?

A. Yes, sir.

Q. Now, then, as a matter of fact, the amount of that reserve authorized by the Court was $7,100,000, was it not? [1126] A. Yes, sir.

Q. And how had that amount in fact been estimated?

(Testimony of Charles Elsey.)

A. It had been accrued on a consolidated basis.

Q. So that what you have in mind, then, in telling us that your statement to the judge was erroneous is that the fact is that you had accrued on a consolidated basis, and you told the judge the filing was estimated on a separate return basis?

A. That is correct.

Q. Now, then, until recently did you have any notion that there was any substantial difference in the one figure from the other?

A. None whatever.

Q. And then recently you learned that there was some such difference between one kind of filing and the other? A. Yes, sir.

The Court: There would have been a difference in the figure?

Mr. Phleger: Not as they then thought it.

The Court: Well, the only difference would be if the stock loss wasn't allowed. It wouldn't make any difference whether it was separate or affiliated, would it?

Mr. Adams: I think I can try and answer that briefly, your Honor. Your Honor will recall that Mr. Buchanan handed in two computations, Basis 1 and Basis 2.

The Court: Oh, yes. [1127]

Mr. Adams: Basis 1 was on the separate return liability without certain credits, without them being taken into consideration.

(Testimony of Charles Elsey.)

The Court: Yes.

Mr. Adams: Now, if your Honor please, to calculate on that basis, you would get a different figure from this $7,000,000 reserve.

The Court: Yes.

Mr. Adams: Does that answer your Honor's question?

The Court: Yes.

Q. (By Mr. Adams): Now, Mr. Elsey, I would like to show you Plaintiff's Exhibit 20-B, being the annual report of the railroad company for 1943 to its stockholders.

(Document handed to witness by the clerk.)

Now, I direct your attention to the text on page 6 of your annual report under the title "Taxes." Do you have that before you? A. Yes, sir.

Q. And of course you have seen that from time to time in the course of your preparation to give your testimony here? A. I have.

Q. It was also directed to your attention upon the taking of your deposition by Mr. Clark?

A. Yes, sir.

Q. Who prepared that text under the heading "Taxes" in that [1128] annual report?

A. Mr. Engelbright.

Q. Did you review it with him? A. I did.

Q. Did you approve it? A. Yes, sir.

Q. I direct your attention to the statement contained in that text, "A consolidated tax return for

(Testimony of Charles Elsey.)

1943 can and will be filed by the holding company." Do you see that there? A. Yes, sir.

Q. Where did that text originate?

A. In my office.

Q. How did it come to you?

A. From Mr. Engelbright.

Q. What was your basis for approving that statement in the annual report that you have in your hands, Plaintiff's Exhibit 20-B?

A. In the first place, we had filed a consolidated return for a number of years. We were advised by Mr. Polk that we could take the corporation's stock loss as a deduction. I received the authority from the reorganization trustees to set up a reserve. Judge St. Sure approved it. And I assumed that in the ordinary course of events we would file a consolidated return, and it was on that basis that I approved Mr. Engelbright's statement that we can and will file a consolidated [1129] return.

Q. Mr. Elsey, approximately when was this annual report, Plaintiff's 20-B, made public?

A. In July of 1944.

Q. I asked you to bring with you some data with respect to the publication of that report, did I not, and the following reports? A. Yes, sir.

Q. And you have that with you?

A. I have.

Q. Will you please state to the Court the extent and manner in which copies of the annual reports to stockholders for the years 1943, 1944 and

(Testimony of Charles Elsey.)

1945 were distributed and otherwise made public.

A. The anual report for——

Q. May I correct my question before you go further? I will eliminate 1945 and this covers only the 1943 and 1944 reports.

A. The 1943 report, we sent a thousand copies on to Mr. Curry, and on June 28, 1944, we received a telegram from Mr. Curry that he had received the reports and that they would be released on July 3, 1944, and we retained 500 copies in our office, which we distributed out to people such as banks, brokerage houses and various statistical concerns who had requested that they be furnished with a copy of the report.

Of the 1944 report there were 5,250 copies printed and [1130] these were sent out, or the majority of them were sent out to the Central Hanover Bank and Trust Company, who were our stock transfer agents, and we kept quite a number of these reports in our possession here in San Francisco and supplied various inquiries for the same.

Q. Do you know whether or not the Central Hanover sent out the annual reports to the stockholders of record according to its transfer agent records? A. Yes, sir.

Mr. Phleger: When was that report sent out?

Q. (By Mr. Adams): Can you give the date, Mr. Elsey, as to the distribution of that report?

A. No, we haven't got the date that the transfer agent sent the reports out.

(Testimony of Charles Elsey.)

Q. Do you have anything that approximates the release date of the report? That is what we would like to have. A. No, I have not.

Mr. Clark: Do you have the date upon which it was sent to the Central Hanover Bank?

Q. (By Mr. Adams): Do you have any date there as to when it was sent to Central Hanover?

A. No, sir.

Mr. Adams: We will obtain the date for the benefit of counsel.

Mr. Phleger: It is not important. [1131]

Q. (By Mr. Adams): According to your recollection was it sometime approximately in the middle of the year? A. I did not get your question.

Q. Would it be approximately in the middle of the year, according to your best recollection?

A. Yes, sir.

Q. That is, the report for 1944 would have been issued approximately in the middle of 1945?

A. That is correct.

Mr. Clark: The report is in evidence, if it please the Court, and shows it. It has a date on it.

Mr. Adams: It is plain, then. Had we known that, we would not have bothered.

Q. Mr. Elsey, I show you two papers. One of them has been marked Interveners' Exhibit 384 upon the depositions, being a telegram from Mr. Schumacher to you of January 29, 1944, and the other is marked in the depositions Railroad Defendants' Exhibit 909, being a letter addressed to

(Testimony of Charles Elsey.)

you by Mr. Ehrman under date of January 26, 1944. I also show you, Mr. Elsey, Plaintiff's Exhibit 56 in this case, being a copy of your letter to Mr. Ehrman of January 24, 1944, and your original letter to Mr. Schumacher of the same date. Now, referring to the copy of the telegram from you to Mr. Schumacher marked Interveners' 384, is that the telegram you received from Mr. Schumacher on or about January 29, 1944, approving the [1132] recommendation you had made to him in Plaintiff's Exhibit 56? A. That is correct.

Q. And referring to the document now marked Railroad Defendants' 909, Mr. Ehrman's letter to you of January 26, 1944, is that Mr. Ehrman's response to you approving the recommendation you suggested to him as of January 24, 1944?

A. It is. [1132-A]

Mr. Adams: I will offer the two documents I have identified, your Honor, telegram from Mr. Schumacher to Mr. Elsey, and a letter from Mr. Ehrman to Mr. Elsey, as Defendant's Exhibit 35A and B.

(The telegram referred to was thereupon received in evidence and marked Defendant's Exhibit 35A, and the letter referred to was received in evidence and marked Defendant's Exhibit 35B.)

Q. (By Mr. Adams): Mr. Elsey, do you recall a visit made by Mr. Polk to San Francisco and your seeing him in October and November of 1944?

(Testimony of Charles Elsey.)

A. Yes, sir.

Q. Do you recall whether or not you had any discussion with him at that time in regard to the use of the holding company's stock loss in the returns for the year 1944?

A. I do not recall it. More than likely we did, but I can't recall any such conversation.

Q. The record in this case shows that the tentative returns for the year 1944 included a return filed by the parent holding company, which included the railroad company and affiliates for the first four months of 1944. The record shows that tentative returns were filed March 15, 1945, and it further shows that final returns were similarly filed on June 15, 1945. So far as you know, Mr. Elsey, were those returns prepared in San Francasco? A. No, sir. [1133]

Q. Where were they prepared?

A. Prepared in New York.

Q. Mr. Elsey, prior to February 11, 1947, had you ever discussed with Mr. Polk or anyone in his firm a proposal for settlement of the tax matter with the government? A. No, sir.

Q. Did you have a discussion of such a proposal on or about February 11, 1947? A. Yes, sir.

Q. And with whom did you have that discussion?

A. Mr. Coulson.

Q. Where did it take place?

A. In my office.

Q. Will you please state the substance of the

(Testimony of Charles Elsey.)

conversation you had with Col. Coulson at that time and place.

A. Col. Coulson called me at my office about nine o'clock in the morning and stated that he had just received a telephone conversation with Mr. Polk in New York. Mr. Polk had stated that——

Q. Just one minute. I am going to take the liberty of interrupting, Mr. Elsey. You just now said, Mr. Elsey, that Mr. Coulson spoke of having received a telephone call from Mr. Polk in New York. Did you mean that?

A. No, Washington.

Q. Go right ahead. [1134]

A. And, as I said before, Mr. Coulson stated that Mr. Polk thought that the time had arrived to make a compromise offer on our tax matters. That compromise matter would be to forego our 1942 taxes and taxes for the year 1943 and the first four months of 1944 would stand as is. Mr. Coulson advised me that in his opinion it was a good settlement.

Q. (By the Court): You do not mean forego the taxes; you mean forego the refund, do you not?

A. Forego the refund, yes, sir. Mr. Coulson stated that Mr. Polk was very anxious to make that offer as soon as possible. Col. Coulson and I discussed the matter as to whether or not I as the president of the company had the authority to authorize Mr Polk to make that proposal, and both of us decided that I did not.

(Testimony of Charles Elsey.)

Q. (By Mr. Adams): And then having come to that conclusion, Mr. Elsey, what did you do next in regard to this proposal for settlement?

A. We decided to call our directors, and I got into telephone conversations with our Western directors and also Mr. Haggerty in New York. I advised them of that situation as to what Mr. Polk's proposition was, and they asked me my opinion as to whether or not it was a good settlement and I said yes, and they gave me their concurrence. I tried to get Mr. Bell, one of our directors, but he was on his way to the Hawaiian Islands and I was unable to reach him. [1135]

Q. You spoke of Mr. Haggerty. Mr. Haggerty was at the time a representative of the Metropolitan Life Insurance Company on the board of the Western Pacific? A. Yes, sir.

Q. Following your discussion with the directors, was there a communication then with Mr. Polk?

A. Yes, sir.

Q. Please go ahead and tell about that.

A. I got Mr. Polk on the telephone and told him that I had received the authority from the majority of our directors and also stated to them that Mr. Polk had prepared a letter for me to sign.

Q. You say Mr. Polk had prepared a letter for you to sign?

A. No, Mr. Coulson had prepared a letter for me to sign. I read that communication to Mr. Polk and told him that he was authorized to make the

(Testimony of Charles Elsey.)

proposal and I would sign that letter and forward it to him immediately.

Mr. Adams: May I have Interveners' 10, please?

Q. Mr. Elsey, I show you Interveners' Exhibit 10 in this case and ask you if that is your file copy of the letter to Mr. Polk of February 11, 1947, that you have been speaking about in your testimony? A. Yes, sir, it is.

Q. And did you send that letter to Mr. Polk that day? A. Yes, sir. [1136]

Q. Mr. Elsey, you did learn, did you not, in July of 1946 that a stockholders' suit had been filed in New York in which a claim was stated in behalf of the holding company on account of the so-called tax savings in this matter? A. Yes, sir.

Q. Prior to that time when you heard about that, had it ever occurred to you that the holding company had any financial interest in the tax case with the government? A. No, sir.

Mr. Clark: I object to that on the ground it is incompetent, irrelevant and immaterial.

Mr. Phleger: I have no objection.

Mr. Clark: I will withdraw the objection, your Honor.

The Court: You would have to be a Solomon to rule on that. I will cut it in half and allow it.

Mr. Clark: I will withdraw the objection.

The Witness: No, sir.

Q. (By Mr. Adams): Did anyone ever suggest that thought to you? A. No, sir.

(Testimony of Charles Elsey.)

Q. What was your understanding as to who would be required to pay any tax, if there were to be a tax assessed for 1943 and the first four months of 1944?

Mr. Clark: Purely hypothetical and immaterial.

Mr. Adams: I will withdraw it. I think the objection was to the fact that I may be asking a question of law. I do not [1137] intend to.

Q. Mr. Elsey, what was your understanding as to who in fact would pay any taxes for the year 1943 or the first four months of 1944 if they should be assessed?

A. Either the reorganization trustees or the reorganized company.

Q. After Mr. Polk began to work on tax questions in the spring of 1943, did you intend to supervise or direct his work? A. No, sir.

Q. Did you form any opinion with respect to the quality of his work? A. Yes.

Mr. Clark: Just a minute, your Honor. I object to that on the ground it is incompetent, irrelevant and immaterial.

The Court: I will sustain the objection.

Q. (By Mr. Adams): Did you rely on his advice in income and excess profits tax matters?

A. Yes, sir, very much so.

Q. Mr. Elsey, before this suit was filed out here in San Francisco, the present suit now on trial—and that filing was in October, 1946, did you have any discussion with any officer or counsel or repre-

(Testimony of Charles Elsey.)

sentative of the holding company regarding the possible institution of the suit? A. No, sir.

Q. Did any one prior to that time suggest to you that such a [1138] suit might or might not be filed? A. No, sir.

* * *

Q. (By Mr. Adams): Mr. Elsey, when was it decided to close the New York office?

A. The latter part of December, '44.

Q. Who made the decision? A. I did.

Q. When was the New York office closed?

A. April 30, 1945.

Q. What arrangements, if any, were made to take care of the employees in the office?

A. All of the employees except Mr. Curry received severance pay of 50% of their annual wage.

Q. And what provision was made at that time for Mr. Curry?

A. To cover him under our pension plan.

Q. Now it is in the record in the case that Mr. Curry was in receipt of a retainer under an arrangement set forth in a letter addressed to him by Col. Coulson in 1945—June, I believe. How and when did you first learn of the proposal to retain Mr. Curry?

A. Well, after it was decided that we were to close the New [1139] York office, I sent Mr. Droit, our secretary, on to New York with instructions to bring back to San Francisco all files and data that belonged to the railroad company. When Mr.

(Testimony of Charles Elsey.)

Droit returned from New York, he told me that Mr. Coulson had stated to him that if we took all the files back to San Francisco, why, the proposition was that they wouldn't be able to consult these files in connection with this tax matter. So it was decided to leave certain of our files in New York, and as Mr. Curry was the person that was most familiar with the files, he would be retained to assist Mr. Polk as far as the matter of our files was concerned.

Q. And that is something Mr. Droit reported to you upon his return to San Francisco?

A. That is correct.

Q. Mr. Elsey, I show you Plaintiff's Exhibit 32A (presented to witness by Clerk), which is a letter addressed to you by Mr. Coulson under date of April 21, 1945, referring to the arrangement for the retainer of Mr. Curry and referring to certain other matters as well. You received that letter in due course? A. Yes, sir.

Q. And you examined it, of course?

A. Yes, sir.

Q. Did you approve the arrangement provided for and recommended in that letter by Mr. Coulson?

A. I did. [1140]

Q. Did you consider that $3,000 a year was a reasonable amount for the purpose?

A. Yes, sir.

Mr. Adams: Now at this time, your Honor, I will take up with Mr. Elsey certain matters having

(Testimony of Charles Elsey.)

to do with our defenses, not narrative in character.

Q. Mr. Elsey, are you familiar with the matter of cut-backs and refunds on the government traffic during the war years? A. Yes, sir, I am.

Q. Can you tell me what those terms mean?

A. Well, when a railroad presents a freight bill to the government, the government pays the bill before it is audited. It takes sometimes several years before the general accounting office gets around to auditing those bills. When they are auditing those bills, they find certain errors. It may be mathematical errors, it might be the wrong rate is applied, or they may contend that that certain shipment shouldn't be entitled to land grant deductions. And when they come to that deduction, they file with the particular railroad a refund claim, and if that refund claim isn't paid very promptly the government deducts the amount that they claim from the next batch of bills that they pay this particular railroad, and those deductions are termed "cut-backs."

Q. Now can you tell me whether the amount of such refunds and cut-backs have been substantial during the war years' traffics? [1141]

* * *

Q. (By the Court): Is that right, Mr. Elsey? Were there some substantial sums involved in that?

A. Yes, sir, very much so.

Q. (By Mr. Adams): Can you give me the approximate amount of the cut-backs and refunds

(Testimony of Charles Elsey.)

which have been made up to a fairly recent date by the Western Pacific Railroad Company on account of Government traffic for the years 1941 through 1944?

Mr. Clark: I object to that on the ground it is not the best evidence, your Honor. There must be records of these things, so we have the actual figures before us.

The Court: Perhaps it is not the best evidence, but I am taking for granted counsel is going to have these accountants testify more precisely on the subject. [1147]

Mr. Adams: That is right, your Honor, and I need this testimony as a basis.

The Court: It is in the nature of preliminary testimony.

Mr. Clark: It is not limited to the period involved.

Mr. Phleger: He says 1941 to 1944.

Mr. Adams: That is right, and the accountants will have to take care of the details. I would like to get an answer to my question as a preliminary question.

The Court: I will allow it.

Q. (By Mr. Adams): Would you like to have the question read, or do you have it in mind, Mr. Elsey? A. Yes, sir.

Q. Will you please answer.

A. Approximately $2,000,000.

Q. Does that approximate figure include all the

(Testimony of Charles Elsey.)

cut-backs and refunds that may be made on account of traffic for these years? A. No, sir.

Q. What does it include?

A. That figure of approximately $2,000,000 includes only the cut-backs and refunds that have actually been audited by our accounting department. There are many cut-backs that the Government has made that we contend are wrong. The Government is still auditing our accounts for those years, and I am satisfied, of course, that there will be more of them presented to us. [1148]

Q. Does it include any figure for the account of intermediate war traffic handled by the Western Pacific during those years?

A. No, sir, none whatever.

Q. Will you explain to the Court how it comes about that you have no figure on the intermediate traffic that you handled?

A. It is the procedure that it is the delivering line that makes all the settlements, and where we are the originating carrier or the intermediate carrier, we have nothing to do as far as the settlement with the Government, and when that delivering line receives a cutback from the Government, they will reapportion that cutback to the various lines that participated in the traffic, and our accounting department is unable, when these figures of interline accounts come from the various railroads, to allocate that charge against us for any particular shipment. [1149]

* * *

(Testimony of Charles Elsey.)

Q. (By Mr. Adams): And Mr. Elsey, can you give me an estimate of the total amount of the Western Pacific cutbacks and refunds on account of Government traffic for the years I have mentioned?

Mr. Phleger: I object to that because it is perfectly obvious that the terms "cutbacks" and "refunds" have been used thus far in the testimony, when the questioning refers to claims by the Government. Just because the Government claims something does not mean that it is the fact. I assume that all the charges the railroad made, it thought it was legitimately entitled to collect.

The Court: What you are trying to elicit is what claims [1155] the Government makes and he suspects there may be more claims made by the Government because he read some place that Congress was investigating the matter and there might be a likelihood of more claims being filed. Can he say anything more than that?

Mr. Adams: This witness?

The Court: Yes.

Mr. Adams: He can tell you that in addition to these figures that he knows about, which he has gotten from his auditor's office with regard to terminal traffic handled, he knows there is going to be more, that he knows there is nothing in those figures for the account of the intermediate traffic. He knows those factors. He knows he has seen this report, and on the foundation of those various

(Testimony of Charles Elsey.)

factors that he knows, he can give me an estimate. I think your Honor will receive an estimate. It only goes to the certainty of it. If he gives you a fair basic statement as to the basic material he has considered in making his estimate, I believe you will receive it. He must be the best informed man there can be produced to ask what additional cutbacks and refunds can be fairly estimated, and that is what I am seeking to get from him.

The Court: Well, I suppose he can say on the basis of the cutback claims that the Government has made, where the Western Pacific was a delivering carrier and thus was directly chargeable with it, that he could compare that amount with the amount in similar cases, where the railroad company [1156] was only an intermediary delivering carrier, and he might on that basis give some estimate. But I don't see what basis there would be for his opinion in any report or Congressional committee, because it might not affect the kind of cases, the subject matter, of transportation involved here, with the Western Pacific.

Mr. Adams: He can answer that question, your Honor; he has read the report. The report describes the kind of transportation he is talking about.

The Court: Well, I will sustain the objection in so far as the witness is called upon to rely upon anything else except the record of his own company.

(Testimony of Charles Elsey.)

Q. (By Mr. Adams): Well, Mr. Elsey, his Honor has said that we can only look to the records of your own company in presenting figures on the aggregate amount of the cutbacks and refunds.

Do I understand your Honor correctly? I don't want to limit myself unless I am sure that I understand your Honor's approach.

The Court: Well, Mr. Elsey, on the basis of the cutbacks upon which claims were made to you by the Government, are you able to make any statement with respect to other similar transactions, with respect to additional cutback claims?

A. Well, I could only say it is a pure estimate. I couldn't [1157] give you any exact figure.

Q. Well, all I am trying to find out is, are you able to make an estimate of some kind on the basis of your own record, the records of your own company?

A. Well, I would say this, your Honor: That we know that we have paid out approximately $2,000,000, and after reviewing this Bender report and found out the sloppy manner in which the Government accounting office audited these bills, and that the committee has instructed the accounting department to recheck all of these freight bills from the very beginning, I can say to myself that to be a conservative estimate, that we would pay approximately 50 per cent more than we have already paid.

Mr. Clark: We move to strike that out, your

(Testimony of Charles Elsey.)

Honor, as being purely speculative and of no proven validity in this case whatever.

The Court: What is that additional 50 per cent you refer to? Is that another million dollars?

A. Yes, sir.

Q. And what kind of transactions would be involved in that?

A. The same type of transactions that are involved in the $2,000,000 that we have already paid.

Q. But only with respect to transportation of an intermediate character?

A. No, where we were also as a terminal carrier. Let me give you an explanation, your Honor. This report brings out the [1158] fact that each department in the General Accounting Office was allocated that they would have to review certain numbers of bills per month—a thousand, 2000 or whatever it might be. Particular groups would find out that toward the end of the month they couldn't make that quota. So what did they do but take a bunch of freight bills and stamp them "Audited," and thereby bring up their quota to the demand of the head of the department. Now, those bills are all going to be re-audited again.

The Court: Well, are the bills that you are speaking of, do they involve the same identical rates or other question as the bills upon which you have calculated the $2,000,000?

The Witness: Yes, sir.

The Court: Just additional ones, is that right?

(Testimony of Charles Elsey.)

The Witness: Yes, sir.

The Court: Now I have asked these questions, and counsel have a perfect right to make the same motions and objections.

Mr. Phleger: Well, they certainly are purely hearsay when this witness testifies that some tired clerk at the end of a month marks something "Audited"; that certainly oughtn't to bind us.

Mr. Clark: On the basis of the very report we have been discussing, your Honor; besides which, the whole thing is speculative. The whole claim hasn't been paid.

The Court: My questions were just directed to find out [1159] the basis on which the witness was going to make the estimate, that is all, rather than as to the admissibility.

Mr. Phleger: Then I move the estimate be stricken out.

The Court: Maybe Mr. Adams would like to develop that further first.

Mr. Adams: Well, I would only ask one question, which I think the witness has already said, but to make sure it is in response to a question:

Q. On the basis of the factors you have considered, Mr. Elsey, what would you say was a reasonable and conservative estimate of the additional amount of refunds and cutbacks for those particular years that will be experienced by the Western Pacific?

Mr. Clark: We object to that, may it please

(Testimony of Charles Elsey.)

your Honor, upon the grounds that it is hearsay, incompetent, irrelevant and immaterial and speculative.

The Court: Well——

Mr. Clark: And that it is of no effect in this case.

The Court: Well, you have, however, from your own accountants proffered testimony as to what the income tax would be if a separate return were filed.

Mr. Clark: Yes, right, on the basis of the figures taken.

The Court: On the basis of the figures that were used in returns that were filed. Now, you do open a door there to the presentation of this sort of thing. The defendants wouldn't be foreclosed, at any rate, from presenting evidence of other factors that might be taken into account in filing separate income tax returns that were not taken into account in the filing of the affiliated return.

Mr. Phleger: Yes, but as of the date when they could not possibly have any effect upon those separate returns, because it is an admitted fact that those years are not open. These are charges that are being made against them now.

Mr. Adams: Your Honor, there is a very ready answer to that: The insistence upon the fact that the consolidated returns are closed. Of course they are closed. They worked out. That is closed. But what we are seeking to prove is what would have happened on a separate return basis. [1161]

* * *

The Court: I will overrule the objection.

(Testimony of Charles Elsey.)

Did you hear the question?

The Witness: Yes. Do you wish me to answer it?

Q. (By Mr. Adams): Yes, please do.

A. I would say that we would pay an additional million dollars.

* * *

The Court: Well, suppose you go along a little bit farther.

Q. (By Mr. Adams): Are you familiar, Mr. Elsey, with the so-called government reparations claims on wartime traffic? A. Yes, sir.

Q. Would you state generally what you understand them to be?

A. The government has taken the position that the railroads of [1164] the country have overcharged the government on various classes of military traffic, and has filed their claim with the Interstate Commerce Commission and are asking for reparations under the Interstate Commerce Act.

Q. And that is wholly different from those refunds and cut-backs you have been speaking of?

A. Entirely.

Q. And according to your information, what is the total amount the government is asking for from the railroads generally in this proceeding?

Mr. Phleger: No, if your Honor please, I object to it upon the ground it is incompetent, irrelevant and immaterial and speculative.

The Court: I can't see what the materiality is,

(Testimony of Charles Elsey.)

what the government is asking the railroads generally.

Mr. Adams: We then proceed and take our percentage of it, your Honor. We just have to start with a figure. Mr. Phleger stated on page 914 of the transcript, I believe the page number is—I am not sure about the page number, though, but I think that is it.

Mr. Phleger: Are you sure it is me?

Mr. Adams: Yes, I am sure that the statement was made by counsel during his statement, and he referred to the fact that this amount involved in this proceeding was such and such a figure, and the witness will agree with you if you will just let [1165] him answer. I would like to have the witness answer if he can, the same question.

Mr. Phleger: You mean as a result of my newspaper reading, I am more informed about these matters?

Mr. Adams: You seem to be well informed, and the witness will give me the same answer you stated, I believe.

Mr. Phleger: Well, I have an objection which I made.

The Court: I haven't got it clear what you are talking about.

Mr. Adams: Mr. Phleger referred to the reparations proceeding on a former occasion in this court, and he named a figure at that time which I think is the same figures the witness will state.

(Testimony of Charles Elsey.)

The Court: What the government is generally claiming from the railroads?

Mr. Adams: Yes, the overall figure.

Mr. Phleger: I think that is wholly immaterial.

Mr. Adams: Well, all we can do with that, your Honor, and the simplest thing to do with it——

The Court: Well——

Mr. Adams: ——is to get the figure to start with, and then see where we go with it. It is preliminary, it is simply a foundational question.

Mr. Clark: This being a claim, your Honor, that hasn't even been established. How can that be deducted from any tax or [1166] income for tax purposes?

* * *

The Court: Well, how can the witness calculate what the Western Pacific's share of this might be? I am just curious to know how that might be done.

Mr. Adams: Well, we can ask the witness.

Q. Mr. Elsey, assuming that you had a figure for the overall amount of the reparations claims against all the railroads in the reparations cases, supposing that you have such a figure in your mind but you don't say it, now then, how would you go about figuring out what the Western Pacific's proportion of that might be?

A. Take the Western Pacific's proportion of the revenue to the total revenue of the railroads as a whole.

(Testimony of Charles Elsey.)

The Court: I know, but they might not all have been hauling military materials.

A. Well no, you couldn't say that——

Q. (By Mr. Adams): Well, don't you know as a fact, Mr. Elsey, that the Western Pacific itself hauled at least its proportion of the wartime traffic? [1167]

A. I would say we handled more.

Mr. Adams: So that, in that case, your Honor, we would make that proportion which would be conservative on the basis of that breakup.

The Court: Well, before I could rule on that, I would have to know more about these reparation claims, what they are and what is the status of them.

Mr. Phleger: Isn't it material if they don't think they are meritorious at all and they believe that they are not obligated to pay them, so that you simply have the merest speculation here now?

Mr. Adams: Well, I would like to answer his Honor's question if I may.

Mr. Phleger: There is no specific claim against this defendant at all—nothing pending.

Q. (By Mr. Adams): Is the Western Pacific a party to that proceeding? A. Yes, sir.

Mr. Adams: That is the answer to that one, your Honor.

Mr. Phleger: Well, is there any claim against them, specifically?

Mr. Adams: Now just one minute, counsel; let

(Testimony of Charles Elsey.)

me go ahead with my statement, because what a reparations proceeding is is a statutory proceeding under the Interstate Commerce Commission Act, and under the Interstate Commerce Act all of us are aware [1168] of the fact that you first have a proceeding to determine the propriety, ex post facto, of the right to what is claimed, and that is what is going on in the reparations proceeding at present. Now as against all claimants other than the government, the statute puts a very short statute of limitations upon the presentation of reparations.

The Court: Are you saying that if this thing results eventually in the assessment of additional claims against the railroad by the government, that all the railroads are going to be able to go back and open up all their income taxes in all the years gone by?

Mr. Adams: Well, let me get the first question, your Honor, which is, What is going to happen to the income? Now these are facts about this. I will ask Mr. Elsey about this.

Q. The fact is, is it not, that the reparations case involves in the main, wartime traffic?

A. Yes, sir.

Q. It involves solely wartime traffic handled for the government's account?

A. That is correct.

Mr. Adams: Now under the statute, your Honor, it is only the government that can come in at as

(Testimony of Charles Elsey.)

late a date as this and seek to recapture tariffs paid to the railroads.

The Court: I understand.

Mr. Adams: Yes. But at this late date, this very large [1169] case is hanging over all the railroads. It is known, it is well known. This is the reparations case. And I am not going to ask Mr. Elsey to give me any estimate of the amount that may come out of that. No such estimate can be made. I would just like to prove, as one of the equities before this court, that there is hanging over the head of his railroad a prospective diminution of its wartime income from governmental sources, and that, I think, is the fact. As to getting the amount, the only amount I can give is the amount of the claim, because it is the only thing known at this time.

The Court: Well, would it be any different than a claim that might have arisen during this same period by virtue of some big accident on the railroads, where the amount of the damage claim against the railroad might not be ascertained until several years afterwards?

Mr. Adams: Yes, yes, your Honor. This is a major attack upon the railroads' wartime income, on the very basis of a claim by the government that they made too large profits. So obviously it is a direct attack upon the income.

The Court: Well, suppose some twenty people got killed in a wreck and had a $2,000,000 claim

(Testimony of Charles Elsey.)

against the railroad company; that would be a direct claim upon the income, wouldn't it?

Mr. Adams: No, it is a direct attack upon the property of the railroad in some way, shape or form. This is an attack upon the income, the very thing the government taxes, and this is an [1170] equity court, and these people are in here asking that there be taken from our clients monies belonging to our clients in any ordinary concept on some theory or other that they are entitled to share in what are called "tax savings," your Honor.

The Court: Well, there is enough in the record to indicate that what your contention is, the nature of those reparations claims, and that it is impossible to estimate them, that they might be a substantial claim against the Western Pacific at some future time.

Mr. Adams: The only thing I want to add to that, so that I might have clearly before your Honor rules, is that the figure that Mr. Phleger mentioned the other day, or as he said, read out of the newspaper, the figure that I want the witness to tell me about, for the overall amount $3,000,000,000. It is very easy to laugh about something if you are not a railroad executive trying to keep it out of the red, and very easy on the part of these gentlemen (indicating) to indicate that they are seeking money from a wealthy concern, that had twice been through reorganization.

The Court: All right, Mr. Adams, you have re-

(Testimony of Charles Elsey.)

viewed this matter. What is the witness' estimate going to be as to what he thinks, if such a huge sum were recoverable by the government against all of the railroads? What would the amount be as to the Western Pacific?

Q. (By Mr. Adams): What would the Western Pacific's part be [1171] if the government should succeed in collecting that huge sum in reparations? A. Four tenths of one per cent.

Q. And that per cent is, I take it, Mr. Elsey, the Western Pacific's per cent of the revenues of the Class 1 rails? A. Yes, sir.

The Court: What does that amount to? Has somebody figured it out already?

Mr. Adams: $12,000,000—4 x 3, 12.

The Court: Now you have sufficient in the record to show what the nature of this evidence is and the nature of your claim. Now for the time being, I will hold, so that your record may be clear, that that is too remote and not reasonably connected with the tax claim, and you can again take that up when the case is finally submitted.

Mr. MacKinnon: Are you striking? I don't know what your Honor is "holding." You say you "hold." The record will either show that you strike or that the evidence is in.

The Court: Well, the evidence is in and I am holding it as immaterial.

Mr. MacKinnon: Well, you are still permitting it to stay?

(Testimony of Charles Elsey.)

The Court: Well, it will stay whether or not I strike it out; it will be there physically.

Mr. MacKinnon: Well, I am trying to get the purport of your Honor's ruling. [1172]

Mr. Phleger: In order that we may have a record, I move at this time that it be stricken.

The Court: All right, I will grant the motion to strike, and that is without prejudice to your rights to further present that question on the submission of the case. [1173]

* * *

Mr. Adams: Now may I also ask counsel for a stipulation based on the record, which we have all examined, that the monies used in the payment of the Federal income and excess profits taxes for the year 1942 were monies taken out of the funds of the Western Pacific Railroad Company while in reorganization [1174] directly cleared through the Chase Bank and paid to the Collector, that that applies to all four installments that were paid covering that year's taxes? Those monies never went through the treasury or bank deposits of the plaintiff corporation, and the plaintiff corporation did not pay any part of those sums.

Mr. Clark: I think that is correct, except Mr. Curry did have some part in the payment to the collectors. Is that not correct?

Mr. Adams: That is correct. Mr. Curry in New York handled the bank drafts that were transmitted in payment of those installments of tax.

(Testimony of Charles Elsey.)

Mr. Phleger: We will so stipulate, and we will ask you to stipulate that the monies which made up those funds were out of current earnings of the properties.

Mr. Adams: I will ask Mr. Elsey that. Nobody has asked me that question before, counsel.

Mr. Phleger: Well, the '43 reserve, as shown by the testimony yesterday, came out of '43 earnings, and I would assume that is correct.

Mr. Adams: You mean the reserves set up.

Mr. Phleger: The '43 taxes came out specifically from 1943 income.

Mr. Adams: Let's ask Mr. Elsey. I have never been asked that question. [1175]

CHARLES ELSEY

resumed.

Direct Examination
(Continued)

By Mr. Adams:

Q. Mr. Elsey, do you know whether the funds that were used in the payment of the 1942 taxes were taken from the earnings of the property while it was in the hands of the trustees during the year 1942? A. Yes, sir.

Q. And what is the answer?

A. Yes, sir, they were.

Mr. Adams: Then we have a stipulation covering all the facts we have recited?

Mr. Phleger: Yes, sir.

(Testimony of Charles Elsey.)

Mr. Clark: That is correct.

Q. (By Mr. Adams): Now, Mr. Elsey, I would like to refer to the Sacramento Northern Railway, which is, as the record here shows, and was during the period of reorganization, a subsidiary of the Western Pacific Railroad Company. That is the fact, is it not? A. Yes, sir.

Q. Now, this railroad company, the Western Pacific Railroad Company, as the record shows, owned substantially all of the bonds of the Sacramento Northern Railway, is that right?

A. That is correct.

Q. Now I will ask you to state whether there was any indebtedness other than this bonded debt that was owing from the [1176] Sacramento Northern to the Western Pacific in the year 1943; and when I say "Western Pacific" I mean the Western Pacific Railroad Company.

A. That is correct, there was.

Q. Now, in what manner was this additional indebtedness evidenced in the accounts of the Western Pacific Railroad Company?

A. By notes receivable and advances in open account.

Q. And do you have with you a statement of the total amount of the indebtedness of the Sacramento Northern to the Western Pacific Railroad Company which was represented by the notes and advances on open account as of the end of the year 1943? A. Yes, sir.

(Testimony of Charles Elsey.)

Q. And will you please state those amounts for the notes and for the open account advances and the total.

A. The notes amounted to $4,524,744.38. Open account advances amounted to $4,949,356.42, or a total of $9,474,100.80.

Q. How did this indebtedness arise?

A. Principally to take care of the operating deficits of the Sacramento Northern.

Q. Have you been familiar with the operation of the Sacramento Northern Railway and with the financial results of those operations during the entire period in which that Sacramento Northern has been a Western Pacific Railroad subsidiary?

A. I have.

Q. Will you please state whether, in your opinion, this [1177] Sacramento Northern Railway indebtedness to the Western Pacific Railroad Company—and by that I refer to the indebtedness on the notes and the open accounts—was, in your opinion, collectible, that is, whether it was reasonable to expect in 1943 that it would be paid?

Mr. Phleger: We now object to that question——

Mr. Clark: Upon the ground that it calls for the conclusion of this witness, may it please your Honor, on a legal matter. The evidence is pointed toward the use of that as a bad debt, which is purely a matter of law.

Mr. Adams: The purpose of the inquiry, your Honor, is this: We will follow with the account-

(Testimony of Charles Elsey.)

ing evidence with regard to the availability of a partial bad debt upon this particular indebtedness during the year 1943. This witness is the man best informed in view of all his history, as to the fact with regard to the value of those receivables, and I am asking him.

The Court: Well, you are asking what his opinion is.

Mr. Adams: I am asking him whether it was collectible. Of course, that is a matter of opinion.

The Court: No, you asked him if in his opinion it was collectible.

Mr. Adams: Yes, your Honor, and for the purposes of the tax law, that is precisely that, a defensible opinion which is material to the question of a partial write-down. The Treasury Department looks at the matter concerning which they wish to find out whether or not, in fact, writing down an asset of this sort may be appropriate. So they ask just the question I now asked Mr. Elsey.

The Court: Well, you mean that if there was an issue between the taxpayer and the Internal Revenue Department as to what debt could be charged off as worthless, whether the debt could be charged off as worthless, that the opinion of the taxpayer is considered as to its worthlessness, of sufficient weight as to be considered on the question of the right to deduct a bad debt?

Mr. Adams: No, your Honor, I do not mean

(Testimony of Charles Elsey.)

that the Treasury Department is bound by the opinion of the taxpayer; but I do mean that the Treasury Department inquires of the opinion of the taxpayer, because certainly the Treasury Department is entitled to have that information, and it does so.

The Court: Well, does it do so in cases mostly questioning the debt, though?

Mr. Adams: Well, it is a very natural thing for the Treasury Department to question as large a deduction as the one here in question.

The Court: Well, as I understand the regulations of the Treasury Department, those regulations covering the matter of such deductions, they have to be definitely ascertained to be worthless; they have to be charged off on the books, and all the requirements of the regulations with respect to bad debts have to be complied with.

Mr. Adams: Not in this case, your Honor.

The Court: And that would be irrespective of what the opinion of anyone was as to whether it was worthless.

Mr. Adams: Your Honor, in the first place, has reference to the matter of charge-off of a debt as worthless, as to which there are other regulations such as those to which you have just referred. There are other regulations and rulings that apply to the writing down of an indebtedness. What is called a partial write-off. We are now speaking of such a write-off, and in that case, however, as in the case to which your Honor refers——

(Testimony of Charles Elsey.)

The Court: You mean the matter of depreciation of accounts receivable as to book value?

Mr. Adams: That is correct, your Honor; the regulations are to this effect, substantially: The rules with regard to an indebtedness which is not wholly worthless—the taxpayer is privileged to select the year in which he may take a partial write-down upon an indebtedness, the value of which does not entirely disappear. The Treasury Department insists that he justify the partial write-down that he takes, and the Treasury Department in the nature of things goes to the taxpayer and says, "What is your view of the opinion? What do you know about this?" and if he is not able to give such an opinion, of course, the Treasury Department is not going to allow it. [1180] It won't be bound by his opinion, but they will require it as important.

The Court: Did the company write off all or any part of the indebtedness of the Sacramento Northern?

Mr. Adams: No.

Mr. Clark: No, sir, it did not.

Mr. Adams: May I answer your Honor's question? Surely this is another instance of the fact —let me put it this way: Your Honor will bear in mind consolidated returns were filed. Now, a partial write-off of an inter-company indebtedness was not a deduction under consolidated return accounting. That is because the transaction was inter-company, and inter-company transactions are

(Testimony of Charles Elsey.)

eliminated when you file consolidated returns. Now, then, we are attacking this problem on the basis of what would have taken place had separate returns been filed, and so we say, your Honor—and this is one of the equities that we bring to the Court—that had that been the case, this matter would have been investigated, the question I have asked Mr. Elsey would have been asked, and if Mr. Elsey answers it in the affirmative and tells me what would have been in his judgment an appropriate figure for write-down, that would have taken place.

It is all hypothetical, as your Honor stated yesterday, but it is based on the essential hypothesis that in order to determine what tax saving, so-called, this company realized [1181] out of these consolidated returns on the basis of a comparison between that and what it would have paid on a separate return basis, it is proper for us to bring forward evidence showing that a deduction could have been taken on a separate return basis which was not in fact taken on a consolidated return basis.

The Court: I understand you said the railroad company owned bonds of the Sacramento Northern. Did it own the stock, too?

Q. (By Mr. Adams): It owned all the stock, did it not, Mr. Elsey? A. Yes, sir.

The Court: Wasn't it the same kind of intercompany transaction that would justify setting

(Testimony of Charles Elsey.)

that up on the affiliated return as between the Western Pacific Railroad Corporation, the holding corporation, and the Western Pacific Railroad Company?

Mr. Adams: No, your Honor. The stock loss was under the law and the regulations a deduction in a consolidated return. Section 23(g)(4) so provided, whereas it is definitely clear under the regulations and the law that the partial write-down of an inter-company indebtedness was not a deduction in the consolidated return but was merely an inter-company transaction that would be disregarded.

The Court: If it had been a total loss in that year, then wouldn't the railroad company have been entitled, or could it [1182] only have set off the loss of the stock of the Sacramento Northern Railroad Company as against the earnings of the Sacramento Northern Railway in the affiliated return?

Mr. Adams: Your Honor, 23(g)(4) applied only to the worthlessness of stock, and in this case I can ask Mr. Elsey the question immediately——

Q. The amount of stock that the Western Pacific Company held, that is, all the outstanding stock of the Sacramento Northern, was approximately $1,000,000, was it not?

A. That is correct.

Q. And then the Western Pacific also had this approximately nine and a half million dollars of notes and open account indebtedness?

A. That is correct.

(Testimony of Charles Elsey.)

Q. And it also had on top of that some millions of bonds of the Sacramento Northern?

A. In excess of five million.

The Court: When the Supreme Court declared the stock of the Western Pacific Corporation worthless, didn't that hold, or impliedly wasn't the effect of that that the stock of the railroad company, the Sacramento Northern, was also worthless?

Mr. Adams: No, your Honor. The Sacramento Northern was not in a Section 77 proceeding. It has never been reorganized.

The Court: As a separate concern?

Mr. Adams: As a separate concern, and in the proceeding of [1183] the Western Pacific Railroad Company the question at issue was, What securities should be issued in the reorganization of that company? And it was in the course of that matter and in consideration of all the matters bearing upon that matter that the Western Pacific Railroad Company was reorganized.

The Court: Was Mr. Elsey the operating head of the Sacramento Northern as well as the railroad company, or was that a separate position?

Q. (By Mr. Adams): That was a separate position, was it not, Mr. Elsey?

A. Separate, yes. I had no official position with the Sacramento Northern.

Q. Mr. Mitchell was the president of the Sacramento Northern Company at that time?

A. Yes, sir, Mr. Harry A. Mitchell.

(Testimony of Charles Elsey.)

Q. And Mr. Mitchell was at the same time one of the officers of the Western Pacific Railroad Company? A. Yes, sir.

Q. What was his office in the Western Pacific?

A. Vice president and general manager.

The Court: You in consequence of your position with the Western Pacific and its ownership of the Sacramento Northern were required to keep yourself closely informed of the Sacramento Northern, were you not? A. Very much so. [1184]

Q. (By Mr. Adams): And particularly with regard to the Western Pacific's investment in the Sacramento Northern?

A. Taking care of its entire financial situation.

Q. And the entire Sacramento Northern system was operated as a part of one railroad system?

A. Yes.

The Court: I do not know how much weight is to be attached to this sort of speculative testimony, but I think in view of the foundation that has been laid, the witness should be permitted to answer that question.

Mr. Phleger: May I make these two statements, one of them bearing upon the speculative character of this: In the first place, I do not agree with counsel's statement of what the regulations are. The general regulations governing the write-off of a partial bad debt are very similar to those of a total debt. The debt has to become bad partially

(Testimony of Charles Elsey.)

during the period in which it is taken. The question is not even framed on that basis, but this is already in the record and uncontradicted. This defendant company accrued taxes during the entire year 1943 in the amount of $7,000,000, closed its books for that year, set up the reserve, reversed the entries; they made no partial tax deduction. They did that at a time that they did not know or had not decided that they would use the plaintiff's stock loss, and so it must be assumed that if they were going to pay $7,000,000 in taxes, that they would have utilized any [1185] offset that they had. And I will make the second observation, and your Honor pointed toward it, if they were going to file separate returns, or even under consolidated returns, the Sacramento Northern stock, if it was worthless, could have been written off, and I do not see how you can take a partial bad debt of the securities of a company and still have its stock worth anything, and they did not attempt to write off the stock of the company, which they could have done under a consolidated return. Now, we have been charged with afterthoughts many times, but this is the most afterthought I have ever heard of. It is in the pure realm of speculation. The record also shows that in the last eight months of 1944, when they could have filed any kind of return that they wanted to, they filed the returns and paid taxes of four or five million dollars. They did not take this loss then.

Mr. Clark: On a consolidated basis, your Honor.

(Testimony of Charles Elsey.)

Mr. Phleger: They could have filed either on a consolidated or a separate basis.

Mr. Clark: They filed on a consolidated basis with the company as a parent.

Mr. Phleger: But they had an option to file on a consolidated basis. They were entitled to take that loss. They did not do it. They paid millions of dollars of taxes. They paid taxes in 1945 and 1946.

The Court: The trouble with that argument is in allowing [1186] this testimony in, I am only allowing it in in connection with the testimony of your accountant, in which he estimated what the tax would have been had a separate return been filed.

Mr. Phleger: But on the basis of the material known at the time, not years afterwards.

The Court: Maybe the question could be reframed. I think the witness should be permitted to give his opinion as to the definitely ascertainable loss during the taxable year of the indebtedness owned by the Sacramento Northern to the Western Pacific Railroad Company, and that that answer may be admissible for what it may be worth in connection with the issue raised by the testimony offered by the plaintiff concerning the matter of what the tax would have been had a separate return been filed by the railroad company for the years in question. You asked the question a little differently from that.

(Testimony of Charles Elsey.)

Mr. Adams: Your Honor, what I asked was a preliminary question. If I may draw it to your Honor's attention you will see it was preliminary. My question was preliminary, and was then to lead to a question substantially as your Honor has said, but I think the preliminary questions should perhaps be asked. The preliminary question was, "Please state whether or not in your opinion this Sacramento Northern Railway indebtedness to the Western Pacific, namely, the open accounts and notes, was collectible, that is, whether it was reasonable to expect that in 1943 it would be paid?" That is just preliminary, and I think the witness may perhaps appropriately answer that [1187] question and then come to the question of how much.

The Court: I think the objection to that question is good, Mr. Adams, but I think a question along the lines that I suggested would go to the fact as to whether or not any part of it was definitely, in the opinion of the witness, uncollectible during that time.

Mr. Adams: I do not want to labor this with your Honor because we have a common objective in mind, but it would seem to me it was a question of fact and a fair question to ask the witness: Was the whole amount collectible, and then if he says "No" to that question, then I will ask him the other. Now, if your Honor does not think that that is the right way to do it—it seemed to me it was appropriate.

(Testimony of Charles Elsey.)

The Court: Of course, the provisions of the statute you are talking about haven't got anything to do with whether or not the whole of the debt is collectible or not. It is whether or not it is definitely determinable during the taxable year that the debt or any part thereof is worthless and uncollectible.

Mr. Levy: Would your Honor like to hear that section?

Mr. Adams: If I might proceed.

The Court: I have had cases under it. I think I am sufficiently familiar with that, and I would allow you to ask the witness questions along that line. That is the only thing that is material under that section, in my opinion, whether or not [1188] this witness from his experience and knowledge and contact with the situation is able to state whether any part of this debt was definitely determined to be worthless and could have been written off during the taxable year.

Mr. Adams: May I again, to save my record, ask the question and then perhaps I might make an offer of proof?

The Court: Very well.

Q. (By Mr. Adams): Mr. Elsey, referring to the indebtedness of the Sacramento Northern to the Western Pacific Railroad Company on notes and open account during the year 1943, to what extent, if at all, was there a definite ascertainable amount by which that indebtedness in your opinion could be written down as uncollectible?

(Testimony of Charles Elsey.)

Mr. Phleger: I object to that. It is not the question that was suggested. The question as suggested was what portion, if any, of that debt was ascertained to be collectible in the year 1943.

The Court: In the opinion of the witness. I think it covers exactly what you want, and then you save yourself from the objection as to the form of the question.

Mr. Adams: Your Honor, I do not want to press this. We have studied this material. We do not accept adverse counsel's statement of just what the rules are. We believe the rule to be on a partial indebtedness that the question is the extent to which the debt is uncollectible at that time, and I so [1189] phrased my question because that is our theory of our defense, and we believe we are correct about that, and we can satisfy your Honor when the time comes to debate the regulations; and I would like to ask the question in that form with your Honor's permission. Of course, if we are on the wrong ground it would be our failure to meet the proper view of the law.

The Court: Will you answer it.

(Question read.)

Mr. Phleger: I object to that on the ground it calls for the conclusion of the witness on an immaterial matter.

The Court: Overruled.

A. I would say that 90 per cent of it was uncollectible.

(Testimony of Charles Elsey.)

Mr. Phleger: I move that that be stricken out as not responsive.

Q. (By Mr. Adams): In my question, Mr. Elsey——

Mr. Phleger: I would like a ruling.

The Court: Let it go out and reframe that.

Mr. Adams: I would suggest that the answer is perfectly responsive. I asked him an amount and, it is true, he gives me a percentage, but a percentage is an amount. That is the only objection to the question that it is not responsive.

Mr. Phleger: No, it is not.

The Court: Mr. Elsey, in your opinion how much of the indebtedness owing the railroad company by the Sacramento Northern Railroad Company in that year could you, in your [1190] opinion, have written off the books as being a loss because of its uncollectibility?

A. I would say 90 per cent of it.

The Court: Now you may have an objection to my question, too.

Mr. Phleger: No, that is all right.

Q. (By Mr. Adams): Mr. Elsey, in answering his Honor's question you were referring, were you not, to the indebtedness of the Sacramento Northern upon the open account and the notes?

A. Yes, sir.

Q. Mr. Elsey, in connection with your answer to his Honor's question did you bear in mind that certain repayments had been made by the Sacramento Northern to the Western Pacific in 1942,

(Testimony of Charles Elsey.)

1943 and 1944 and 1945? A. Yes, sir.

Q. Do you have with you a notation of the amount of those repayments? A. Yes, sir.

Q. Will you please state them to the Court?

Mr. Phleger: Do I take it, if it please your Honor, that these are payments on what was then the balance of the open account or the notes? I do not understand the word "repayments."

Mr. Adams: Mr. Elsey can answer those questions in due course, but let us get along with this. I am trying to lay the [1191] facts before the Court and before counsel.

The Court: Go ahead.

A. In 1942 the Sacramento Northern paid to the Western Pacific on account of notes and advances $22,000; 1943, $103,000; 1944, $170,000; 1945, $100,000, a total of $595,000. [1191-A]

Q. Now during those years did the Sacramento Northern pay to the Western Pacific the interest on its bonded debts? A. No, sir.

Q. And you considered, in giving your answer, the fact that these repayments had been made during those years? A. Yes, sir.

Mr. Adams: Now in another aspect of our defense, your Honor, I have asked Mr. Elsey to bring some information to Court which he has, with regard to the conversion of income bonds of the reorganized railroad company. Part of the financial structure of the reorganized company, after it was reorganized, was income bonds convertible into common stock. The sole purpose that I have in making

(Testimony of Charles Elsey.)

this offer is as a part of our defenses of estoppel and laches, to show the change of position which occurred between the time of the transactions themselves and the time that the lawsuit was brought. And I make that explanation so that counsel may know the purpose of this offer.

Q. Now, Mr. Elsey, what was the total amount of income bonds actually issued under the plan of reorganization by the reorganized company?

A. $21,219,000.

Q. These bonds had a conversion privilege, did they not? A. They did.

Q. What was the nature of the privilege?

A. 20 shares of common stock for each thousand dollars face [1192] amount of 4½% income bonds.

Q. To what extent have any of these bonds been converted into common stock from the time of issuance until July, 1946? You have that figure?

Mr. Clark: Well, I object to that question.

A. No.

Mr. Clark: Upon the ground it is incompetent, irrelevant and immaterial. Apparently, your Honor, the conversion was on the part of bondholders or creditors of the defendant company who chose to become stockholders. There was no showing as to their reasons for so choosing. I fail to see how that can possibly constitute a change of position on the part of the defendant company which is necessary to the establishment of the defense of laches.

(Testimony of Charles Elsey.)

Mr. Phleger: Well, not only that, until he shows, or rather I think the record already shows, that one of the interests, the largest one, converted theirs—the James interests, who knew all about this controversy, and furthermore, how could any estoppel arise when the records and the annual reports show that these matters had been reserved? Isn't that a question of law in this case?

The Court: Well, that seems to me, though, a question of the legal effect of the facts. You may be entirely right in your argument. I am not prepared to rule on that. But the fact itself cannot, or probably is not, subject to dispute. It is mainly as to how much of the bonds would be converted. Now as to what the effect of that is, as a legal question, we could probably reserve ruling on that, couldn't we?

Mr. Phleger: Well, it is also a factual question, too, isn't it, as to what the motives would be?

The Court: I assume there wouldn't be any controversy as to how much the bonds were, how many were converted.

Mr. Phleger: No.

Mr. Clark: We have no quarrel with that.

The Court: As to that extent, it would be harmless, anyhow, even if it goes in evidence.

Mr. Clark: We have no quarrel with that; it is simply the effects of it that is material.

The Court: I will overrule the objection.

Q. (By Mr. Adams): Mr. Elsey, do you have that figure to the middle of 1946?

(Testimony of Charles Elsey.)

A. The end of 1946?

Q. No, the middle of 1946.

The Court: You are referring to the date the suit was filed in New York?

Mr. Adams: That is the beginning of the New York action, yes.

Q. My recollection is, Mr. Elsey, that we don't have that figure. A. I think I have.

Q. You do? That's splendid; then we can have it now. [1194]

A. The amount of the bonds converted to the end of 1946 was $4,489,300.

Q. Now do you have it to the middle of 1946?

A. No, I have not.

Mr. Adams: May we at a later date, your Honor, supply that figure without recalling the witness, and counsel may have an opportunity to check it?

The Court: Yes.

Mr. Adams: I have no further questions, your Honor.

Cross-Examination

By Mr. Phleger:

Q. Have any of those convertible bonds been converted since 1946?

A. Yes, there is $3,000 converted, face value, converted in April, '47.

Q. That is the last?

A. That is the last.

Q. Now how much of the bonds that were con-

(Testimony of Charles Elsey.)

verted of the $4,489,000 that you have just told us about, belong to the James interests?

A. $3,707,800.

Q. The James interests are represented by Mr. Coulson, are they not?

A. What is that?

Mr. Adams: Your Honor, may I make an objection to the question? That is my sole purpose. It is wholly immaterial who [1195] made the conversion as long as the conversion was made prior to the notice of the existence of this claim.

The Court: Well, of course that is the same—I can rule on that the same as I ruled on the other objection. The fact itself is there, and you cannot use a legal conclusion from that.

Mr. Phleger: Well, I even meet the challenge of counsel because I show that almost all of these bonds belonged to the very man that conceived the method of saving taxes. So that there couldn't have been any misleading of him.

Mr. Adams: Well, there certainly could be a misleading of anyone in the non-assertion of a claim, your Honor; that is a point of my position.

Mr. Phleger: Well, you will stipulate that Mr. Coulson represents the James interests, won't you?

Mr. Adams: Mr. Coulson will be here and testify, and of course it is the fact and has been an advertised and patent fact since prior to the institution of this reorganization in 1935.

The Court: All right, on the same ground I will

(Testimony of Charles Elsey.)

overrule the objection as I did of plaintiff's counsel. I will overrule the objection.

Q. (By Mr. Phleger): Now, Mr. Elsey, how much of the $9,474,100.80 owed by the Sacramento Northern to the Western Pacific Railway was collectible on December 31, 1942?

Mr. Adams: May I object to the question, your Honor, and [1196] state my reason? The law with regard to partial write-offs is definitely to the effect that even though a partial write-off would have been justified in prior years, the taxpayer does not have to take it. He can take the partial write-off. This is as distinct from the total write-off. He can take a partial write-off of an indebtedness even though in prior years such a partial write-off would have been appropriate. Now upon that ground I object to the question.

The Court: I will overrule the objection.

A. In December of '42 we paid, the Sacramento Northern paid the Western Pacific, $222,000.

The Court: No, he wants to know how much of that 90% that you spoke about could have been written off as uncollectible on December 31, 1942. Is that right?

A. I would say the same amount.

Q. (By Mr. Phleger): Now what were the best operating years of the Sacramento Northern in the last ten years? A. During the war period.

Q. What years?

A. I would say '43 to '45.

(Testimony of Charles Elsey.)

Q. It had operating profits in each of those years, did it not? A. No, I don't think so.

Q. What years did it have profits in?

A. I couldn't tell you offhand.

Q. It had a profit in 1943, didn't it? [1197]

A. I think it did, yes.

Q. Now the Sacramento Northern is an integral part of the Western Pacific system, is it not?

A. Yes, sir.

Q. And its continued ownership was provided for in the reorganization plan, was it not?

A. No.

Mr. Adams: Well, the plan speaks for itself.

Mr. Phleger: Well, I have read it.

Q. As a matter of fact, the plan provides that the earnings of the Sacramento Northern shall be consolidated with those of the Western Pacific Railway, and in order to determine certain earnings for the purpose of paying on income bonds——

Mr. MacKinnon: That is objected to on the ground the plan speaks for itself.

A. Yes.

Mr. Phleger: Well, the witness has already answered it "yes."

Mr. MacKinnon: It doesn't make any difference, the objection is made.

The Court: I see no harm in that question; if that is a correct statement, counsel. Overruled.

Q. (By Mr. Phleger): The answer is "yes"?

A. Yes.

(Testimony of Charles Elsey.)

Q. The Western Pacific at all times controlled the Sacramento [1198] Northern?

A. Yes, sir.

Q. And it determined itself, did it not, the time and amounts of these payments that you referred to? A. Yes, sir.

Q. When you wanted a payment, you told them to pay you? A. Absolutely.

Q. What was the purpose of these advances that were made over the years?

A. Both for the operating deficits and for capital expenditures.

Q. To keep the road running? A. Yes, sir.

Q. When you made those advances, did you do so with the expectation of collecting them?

A. That all depended on what the future held out as far as traffic was concerned.

Q. Well, you advanced them to keep it running?

A. That is right.

Q. Not with the idea of collecting them again, except as subsequent events might turn out?

A. That is correct. [1199]

* * *

Q. Will you explain to the court just what a cutback and a refund is? You said you paid them. Does that mean you paid out monies in cash?

A. You would on a refund, but on a cutback it has already been deducted by the government.

Q. In other words, it is a book transaction?

A. They just charge your account. That is it.

(Testimony of Charles Elsey.)

Q. So that when you said you had paid it, it is subject to that qualification?

A. That is correct.

Q. How much of these were cutbacks and how much were refunds?

A. I couldn't tell you. The vast majority of them were cutbacks.

Q. The vast majority were cutbacks. Now when you paid these charges in 1942, '43 and '44, you thought the charges were proper charges against the government, didn't you?

A. That is correct.

Q. And when they cut back on you or required a refund, did you change your mind?

A. That was dependable on what the circumstances brought out, [1200] and also the decisions of the United States Supreme Court.

Q. Well, none of these matters have been litigated, have they? A. Yes, sir.

Q. How much of the payments that you have made on cutbacks were pursuant to court order or adjudication? A. I couldn't say.

Q. You haven't any idea?

A. Not at all. It has been quite a number of cases rendered by the Supreme Court on various commodities, but it would take a vast amount of accounting work to go through that.

Q. So far as you know, that has never been done? A. No, sir, not that I know of.

Q. So that that figure isn't available?

A. No, sir.

(Testimony of Charles Elsey.)

Q. Now have you abandoned, or did you abandon, in behalf of the railroad all hope of collecting these amounts that had been charged against you by cutbacks? A. No, sir.

Q. You still think they are due you?

A. No, no, not all of them, of course; the proposition is this: at the beginning of the war, for security reasons, the government did not comply with all of the tariff provisions. That is particularly true on export traffic. And under export tariffs, in order to secure the export rate, which is always lower than the domestic rate, the shipment would have to move out on a [1201] commercial vessel. It was later decided, after a conference between the military people and the railroads as a whole, that we would grant them not only the export rate, but also the land grant deduction on all shipments, whether it moved on government vessels or whether it moved on commercial vessels. And these cutbacks make up a large portion of that class of traffic. And in order to secure that—not only the export rate but the land grant deduction—the government had got to support with what we call an "export certificate," showing that the shipment did actually move out of a Pacific Coast harbor.

Q. Well, now, I understood you to testify that no compilation has been made as yet as to how much of these cutbacks are ultimately justified and how many you still dispute? A. No.

Q. Now with respect to the payments, the cut-

(Testimony of Charles Elsey.)

backs that you thought were justified, how did you treat them income tax-wise?

A. I couldn't tell you.

Q. You didn't direct that they be deducted from the taxes paid during the years in which they were actually paid out?

A. That is a matter that would be handled between our accounting department and our tax counsel.

Q. And you have no knowledge?

A. No, sir, I have none.

Q. Mr. Elsey, was the Sacramento Northern debts collectible in full as of December 31, 1941?

A. No, sir.

Q. How much of it was uncollectible then?

A. I couldn't tell you.

Q. More than 90%?

A. The percentage, as far as any particular date was concerned, would be—the controlling factor there in that matter would be as to how long the war was to last.

Q. Well, now, I am asking you to estimate how much of that Sacramento Northern debt was collectible on the last day of 1941.

A. I couldn't tell you.

Q. You have no judgment on that, although you have on '42 and '43?

A. Yes, because the war was in effect, and as far as the end of '41 was concerned, why, we were only in the war for a little more than a month, and

(Testimony of Charles Elsey.)

we had no idea at all as to what amount of war traffic the Sacramento Northern was handling.

Q. Well, then, your judgment would be that more, a greater part of it, would be uncollectible at the end of '41 than at the end of '42 or '43, isn't that so? A. I would say so, yes.

Q. It was less collectible, then? A. Yes.

Q. As a matter of fact, it was more collectible in 1943 than for any year in the ten previous years, wasn't it? A. I would say so, yes. [1203]

Mr. Phleger: That is all.

Cross-Examination
(Interveners)

By Mr. Clark:

Q. Mr. Elsey, prior to the time you testified before Judge St. Sure on March 3 of 1944, in support of the tax reserve, had there been inquiries made of the company by any persons respecting the reversal of the 1943 tax accruals?

A. You mean people outside of our organization?

Q. Yes, sir. A. Not that I recall.

Q. In order to refresh your recollection on that subject, let me show you a telegram marked "Railroad Defendant's Exhibit 910" on deposition, addressed to you as president of the company, by Shelley Pierce, financial editor, Journal of Commerce, on January 28, 1944, and after examining that, Mr. Elsey, I will ask you whether or not

(Testimony of Charles Elsey.)

during January of '44 the company was in receipt of inquiries from the press and members of the public concerning the reason for the reversal of the tax accruals which had been accrued during '43 on a consolidated basis. (Handing to witness.)

Mr. MacKinnon: I object to it on the ground it is irrelevant and immaterial to any issue in the action. [1204]

* * *

Mr. Clark: May I have the question read back?

The Court: Well, I think the witness heard it, Mr. Clark. Did you hear the question?

The Witness: Yes.

Q. (By Mr. Clark): Well, Mr. Elsey, is your recollection now [1205] refreshed that the company did receive such inquiries?

A. That is correct, they did receive them after we issued our reports for December of '43 for the year '43. That was given out to the press on either January 25 or January 26, as I recall it.

Q. I see. And is the telegram I have shown you one of those inquiries? A. Yes, sir.

Q. By the way, do you remember approximately when it was that the books of the company were closed for the year 1943?

A. I would say about the 18th of January, somewheres in that vicinity.

Q. Now, Mr. Elsey, let me show you a photostatic copy of the telegram addressed to Shelley Pierce, financial editor, Journal of Commerce, New York, dated January 28, 1944, and signed "Charles

(Testimony of Charles Elsey.)

Elsey" which has been marked Interveners' Exhibit 325 on deposition (handing to witness). I will ask you whether you recollect sending that telegram.

A. Well, there is no question but what that telegram was sent by my office.

Q. All right. Now, directing your attention, Mr. Elsey, to the portion of the text of this telegram within the words "quote" and "unquote," will you state whether or not that was a prepared statement which had been decided upon so far as answering any such inquiries was concerned?

Mr. MacKinnon: May I have a continuing objection to all this testimony on the ground it is irrelevant and immaterial?

The Court: I don't *what* what this is about.

Mr. MacKinnon: This is the same subject matter that you ruled on before.

The Court: Well, all that the witness has testified to, so far as that is concerned, is that his recollection was refreshed, and they did receive inquiries as to why there was this reversal of the item. That is all the testimony there is. I don't see why that required any further elucidation, unless this is a new subject matter. I don't know whether it is or not.

Mr. Clark: Well, may it please your Honor, on direct examination Mr. Adams asked Mr. Elsey, and the purpose is obvious, whether or not——

The Court: You don't have to argue the matter,

(Testimony of Charles Elsey.)

because I don't know what it is you are trying to bring out.

Mr. Clark: Very well, will you please answer the question?

A. No, it was not a cut and dried proposition.

Q. (By Mr. Clark): It was not a prepared statement? A. No, sir.

Q. And I refer to the language in the telegram between the words "quote" and "unquote"?

A. That is correct.

Mr. Clark: May it please your Honor, we will offer this telegram, or rather the copy of it, in evidence as Interveners' [1207] Exhibit next in order.

Mr. MacKinnon: I object to it on the ground it is irrelevant and immaterial to any issue in the action.

The Court: Let me see it. I cannot rule on this without knowing what it is.

(Document handed to court through clerk.)

Mr. Clark: Your Honor will observe there is no mention of the stock loss, and this series of correspondence bears directly upon the defense of laches, and particularly Mr. Adams' eliciting of this witness that all inquiries were answered with full and complete data, and particularly his reason for going into the testimony concerning stock loss before Judge St. Sure, and your Honor will find particularly with respect to the Sacramento Northern set off, as bearing upon laches, that this period is particularly critical. Now I propose to

(Testimony of Charles Elsey.)

show, may it please your Honor, that during this time, the only statement given by the company to the public which would have been the answer to any inquiry the stockholders may have made, would have been that which is included in that telegram, which assigns the reason for the tax saving to be a reduction in capitalization of the company; namely, the defendant, instead of the stock loss. It bears directly on laches, and it is directly responsive to Mr. Adams' direct examination. I also propose to show who approved that language, and the employees were instructed to give no other information, and that was suggested to Mr. Schumacher in New [1208] York, that he make no further comments than the quoted language.

The Court: What was the point of all that?

Mr. Clark: Simply to show that during this period of time, may it please your Honor, so far as inquiries addressed to the company were concerned, they were not making public this very thing which is before your Honor, namely, the use of the holding corporation's stock loss, which bears upon their present defense of laches. They claim we should have asserted some claim at this time, and with respect to the Sacramento Northern situation, it is certainly pertinent, because there is a date in this period upon which that turns. The proof consists of two other documents and about three questions, your Honor.

The Court: What is the basis of the objection, so I can get it clear?

(Testimony of Charles Elsey.)

Mr. MacKinnon: It is completely irrelevant and immaterial to any issue in the action. The accrual of the tax reserve was an accrual made in the normal and natural way, application made to to the reorganization court, Judge St. Sure passed upon it, the reserve was passed on, and with respect to the specific document that you have before you, if we are going into this, we have got a newspaper article by Shelley Pierce, which we will offer, where he comments on this very stock loss. I say these things are completely irrelevant and immaterial to the issue before you.

Mr. Clark: All later in time, your Honor. All publicity on this matter, your Honor, was subsequent to the hearing on the [1209] tax reserves.

The Court: So was this, wasn't it?

Mr. Clark: Oh, no, the hearing on the tax reserve was March 3; this was January. The purpose of this is to establish that up until the testimony before Judge St. Sure on the tax [1209A] reserve, there was a deliberate effort on the part of the company to keep quiet the use of the stock loss, which bears upon any defense of laches, and this establishes it.

Mr. Adams: I do not rise to make an objection, but to indicate that, of course, Mr. Clark's statement of his own arguments is, I take it, a statement of argument and that is all. If I were to follow him closely, I might have some differences with him about his own statement of facts.

The Court: You have asserted the defense of laches?

(Testimony of Charles Elsey.)

Mr. Adams: I have.

The Court: You did go into that somewhat with this witness, although not in particular detail, and, of course, this might be—I am unable to evaluate it at the moment, but it may have some relevancy to the question of laches which I am unable to determine at the moment.

Mr. Clark: May it please the Court, the direct question was asked by Mr. Adams on his direct examination unrelated to any event at all whether any information requested by any party to the reorganization proceeding was given as promptly and as fully as possible.

Mr. MacKinnon: What page, please?

Mr. Clark: I do not know the page. I took it down as it was given. I checked it this morning; it is in the transcript. Would you like me to get it?

Mr. MacKinnon: Yes, I would like to see it. I certainly [1210] remember no such testimony.

Mr. Clark: I certainly remember it and made a note of it. Page 1092, your Honor, line 6:

"Q. During this trusteeship, what was your practice with respect to furnishing information when it was requested by parties to the reorganization proceeding?

"A. We always furnished any information that was requested just as promptly and just as fully as we possibly could to them."

Mr. MacKinnon: Your Honor——

Mr. Clark: Just a minute, please. Now, Mr.

(Testimony of Charles Elsey.)

Matthew made a point of introducing, may it please your Honor, the intervention of the holding corporation in the reorganization proceeding for the purpose of protecting itself under the plan. The argument will be made that the plaintiff corporation was a party to the proceeding and should have come in and asserted its claim, and so forth, and I propose to show to your Honor, that during this particular time, upon the approval of Mr. Coulson, the only information which was being given out by the company did not mention any use of the plaintiff corporation's stock loss, so that any person who was not an officer of both the company and the corporation, that is, any disinterested person or the interveners, if you will, could not have gotten this information. That is the point of it.

The Court: They could have gotten it in the reorganization [1211] proceeding, couldn't they?

Mr. Clark: They could not up to that time.

The Court: Not up to that time but they could at that time.

Mr. Clark: Not at that time, your Honor. This is January, 1944.

The Court: They could have at the time the petition was filed.

Mr. Clark: The petition said nothing about the use of a stock loss, your Honor. You mean the petition for a reserve?

The Court: Yes.

Mr. Clark: It says nothing about the use of

(Testimony of Charles Elsey.)

this stock loss. It simply talks generally about federal taxes, and I have something to show your Honor on that, too.

Mr. MacKinnon: Let me make one response on this. This is the reference that counsel says has to do with the general inquiry by Mr. Adams. Mr. Adams asked him this question:

"Q. During this trusteeship what was your practice with respect to furnishing information when it was requested by the parties to the reorganization proceeding?"

Shelley Pierce was not a party to the reorganization proceedings and never purported to be a party to the reorganization proceeding, and the response made by Mr. Elsey to the question asked, and the question asked was designed to elicit information with respect to parties, namely, whether or not information was furnished the plaintiff when they requested it—— [1212]

Mr. Clark: We will follow this up with a general showing.

Mr. MacKinnon: Permit me to continue, will you, please? What they are attempting to do here is to distort the picture. This reserve and the accruals were handled under Judge St. Sure. Now they pick up an isolated document and they say, "This is what was said." I can show to your Honor a newspaper article by Shelley Pierce wherein he made specific reference to this stock loss. That is the field we are going into if this field is opened up.

(Testimony of Charles Elsey.)

I do not see its relevancy or materiality to the issue to be determined in this action, and I do not see how it in any wise bears upon any laches.

Mr. Clark: There must be something to it or counsel would not resist so strenuously.

The Court: Oh, I do not know about that. Lawyers usually resist anything the other fellow offers.

Mr. MacKinnon: It is just one more of these asides.

The Court: I cannot see what the president of the company said in a telegram to some newspaper man and what he published has any particular bearing upon the legal rights of the parties or these defenses.

Mr. Clark: Perhaps, your Honor, it will be of some aid if you examine the other two exhibits which I intend to offer in this connection.

The Court: One is a telegram to Mr. Schumacher from Mr. Elsey——

Mr. Clark: One is Interveners' 246 and the other is [1213] Interveners' 324, in which the identical language appears.

The Court: Well, I do not see the bearing on this matter as to what kind of releases were given the press or the public on this matter. What has that got to do with the legal issue?

Mr. Clark: It certainly has to do, your Honor, with the defense of laches which is being urged here.

(Testimony of Charles Elsey.)

The Court: I do not see how it has any bearing on that. Do you mean to say that somebody gets some right because some newspaper publishes something? Some information is given the newspapers?

Mr. Clark: If it please the Court, the defense of laches rests on knowledge or the facts which should have put people upon notice. Laches has been urged against these interveners.

The Court: I have my own suspicions as to why these statements were given to the press. Maybe they are justified or not. It probably has something to do with the activities of the Stock Exchange. But what has that to do with the rights that are involved here?

Mr. Clark: May it please the Court, suppose I offer them for identification. I have made my offer of proof. The record shows the purpose of them.

The Court: Let the three documents be marked for identification.

Mr. Clark: Being first a telegram from Elsey to Shelley Pierce, dated January 28, 1944, marked on deposition Interveners' [1214] Exhibit 325, as Interveners' Exhibit next in order.

The Clerk: Shall I mark these as one exhibit?

Mr. Clark: Yes, 18A, B and C. Next, a telegram from Charles Elsey to T. M. Schumacher, dated January 28, 1944, Interveners' Exhibit 246 on deposition; and nextly, a memorandum dated January 25, 1944, signed Charles Elsey in typing, being Interveners' Exhibit 324 on deposition.

(Testimony of Charles Elsey.)

(The documents referred to were thereupon marked Interveners' Exhibits 18A, B and C, respectively, for identification.)

Mr. Clark: May I have Plaintiff's Exhibit 53, please?

The Court: I think before you proceed we might take a brief recess.

Mr. Clark: Very well, your Honor.

(Recess.)

Q. (By Mr. Clark): Now, Mr. Elsey, with respect to the January 11, 1944, opinion, which is Plaintiff's Exhibit 54 in this case, was there an arrangement that that opinion would not be effective until cleared by Mr. Coulson from New York?

Mr. Adams: The witness is entitled to see the paper if he wishes it in that connection.

Q. (By Mr. Clark): You have in mind the opinion I am talking about, have you not, Mr. Elsey? A. You mean Mr. Polk's opinion?

Q. The opinion dated January 11, 1944, which you requested. A. Oh, yes, yes. [1215]

Q. Concerning these tax matters?

A. Yes, sir.

Q. You have that in mind? A. Yes, sir.

Q. My question was whether or not there was an arrangement that that opinion, although left with you by Mr. Polk, would not be effective until released by Mr. Coulson from New York?

A. No, not Mr. Coulson. Mr. Polk stated that

(Testimony of Charles Elsey.)

he wanted that matter gone over with his associates.

Q. Let me show you in that connection a photostatic copy of a telegram from you to Mr. Coulson dated January 15, 1944, Interveners' Exhibit 346 on deposition, and see if that refreshes your recollection about that matter.

A. That is correct.

Mr. Clark: We will offer this telegram in evidence, your Honor, as Interveners' Exhibit next in order.

Mr. MacKinnon: That is objected to as irrelevant and immaterial. If he wants to put in the full record, it comes out to the same question we had a minute ago. The record shows that Mr. Polk was out in California at the time the opinion was requested, that he wrote a telegram to New York requesting a checking of figures that he was releasing in connection with the opinion. There is a telegram. They have seen it. They take an isolated telegram, they say, "We want to offer this." I think, your Honor, I do not care whether all this goes in; if [1215-A] you want the complete record here, that is o.k. But let us understand that we are putting in the complete record rather than these isolated telegrams on which they are going to ask you to draw inferences and make implications. I say the telegram is completely irrelevant and immaterial to the issue before your Honor.

The Court: Counsel, all that is before the Court is this: The witness stated in answer to a question

(Testimony of Charles Elsey.)

of counsel that he had a certain view concerning the release of this opinion.

Mr. MacKinnon: That is right.

The Court: Then counsel showed him some telegram, which I have not seen yet and do not know anything about, and asked him if that refreshed his recollection about it. The witness said it did. Now, I do not know what is in the telegram.

Mr. MacKinnon: And now he offers it.

The Court: I do not know whether it is of any importance. Why don't you ask him the question, his recollection having been refreshed by whatever you have shown him, what does he now state?

Q. (By Mr. Clark): Your recollection now having been refreshed, Mr. Elsey, will you please tell us whether there was such an arrangement as I call your attention to? A. Yes.

Q. Can you tell us approximately when it was that Colonel Coulson released the opinion by notification to you? A. I couldn't say.

Q. Again let me show you the telegram to which I just called your attention. A. Yes.

Q. What was the approximate date? [1217]

A. The date of this telegram was January 15.

Q. Was that the date upon which the opinion was released? A. I could not say.

Q. Was it after this date of January 15, 1944?

A. Yes.

Q. Very well. In that regard, just so the record may be clear about it, let me show you another

(Testimony of Charles Elsey.)

telegram, Interveners' 71 on deposition, and see if you can tell us the date upon which you received the release of the opinion from Mr. Coulson.

A. Yes, but I did not receive the revised opinion until after the date of January 15.

Q. Am I correct in stating that as of approximately January 15, 1944, Mr. Coulson did release the opinion? A. Yes.

Q. Very well. Now, was it after that, Mr. Elsey, that the books for the year 1943 of the railroad company were closed? A. Yes, sir.

Q. I hand you a memorandum dated January 8, 1944, which has been received as Plaintiff's Exhibit 53 in this case, and I will ask you to examine it commencing with the last paragraph on the first page.

Mr. Adams: Of course, the witness is privileged to examine the whole memorandum, Mr. Clark.

Mr. Clark: No doubt about it, your Honor.

The Witness: What is under this? [1218]

Mr. Clark: Suppose I read it, your Honor? It is in evidence anyway.

The Court: What question are you going to put? Let us have a question.

Mr. Clark: I am going to ask him about a reserve fund that is mentioned in this memorandum, and I would like to call your Honor's attention, as well as the witness', to the portion of the memorandum on which I am going to examine him. Apparently there is a label over some of the language on the exhibit.

(Testimony of Charles Elsey.)

Mr. MacKinnon: Will you state whose memorandum that is?

Mr. Clark: Mr. Polk's memorandum of January 8, 1944, in which he refers to conferences had with Mr. Elsey, Mr. Engelbright, Mr. DeGraff, Mr. Glaster, et cetera.

Mr. Adams: Did you speak of that as a conference, Mr. Clark?

Mr. Clark: Conferences, I said.

"There has been accrued on the operating company's books through November a reserve for Federal tax liability of approximately $7,500,000. Since there will be no tax liability if this operating loss deduction on a consolidated return basis is allowed, the suggestion was made that the books of account be adjusted so as to reflect at December 31 no accrual for Federal tax liability on the part of [1219] the operating company for 1943. After considerable discussion it was decided tentatively to set up a reserve for road improvement in an amount approximating the $7,500,000 figure. This action is to be taken upon order of the court after appropriate application for same."

Q. Mr. Elsey, at any conference which you attended on January 8, 1944, or at any time during January respecting these tax matters, did you ever hear any suggestion that a reserve for road improvement be set up in the amount of $7,500,000?

Mr. MacKinnon: I object to it on the ground it is irrelevant and immaterial to any issue in the action.

(Testimony of Charles Elsey.)

Mr. Clark: It bears directly upon the setting up of this reserve.

Mr. MacKinnon: It has no bearing upon it whatever. It is completely extraneous to the issue.

The Court: What is the importance of this, Mr. Clark, in the cross-examination of this witness?

Mr. Clark: I propose to show, if it please your Honor, that he has testified as to the setting up of the reserve and the reason for it, and on the same subject that I offered the releases to the public, which offer your Honor refused, namely, bearing in mind the effort at this time to keep attention from this tax matter on the part of those who were handling it, I propose to show—and the memorandum so states in effect—that there [1220] was discussed the labeling of this reserve, not as one for Federal taxes, but as a reserve for road improvement. And I also propose to show that there was even submitted to Mr. Elsey a petition to be filed in the court which labeled this reserve fund a reserve for taxes, and some language along the line of road improvement, post-war modernization, and so forth, and I further propose to show that when that petition was submitted to Mr. Elsey he refused to sign it because, in his testimony given on deposition, he refused to appear in support of anything that was not correct before Judge St. Sure.

Mr. Adams: Now, counsel, if you are going to attempt to state testimony, I suggest that the whole of the testimony be stated. Certainly if Mr. Elsey

(Testimony of Charles Elsey.)

is to be asked about this, that characterization of his testimony is not to stand alone and he should be asked.

Mr. Clark: The testimony on the deposition, your Honor, was this, in line with the offer that I am making——

Mr. Adams: I ask you to read the whole of it, on that subject.

Mr. Clark: I will read this part of it on page 280 commencing at line 2:

"When this letter and its attachments came from Mr. Matthew, did you discuss them with Mr. Engelbright"——

Mr. Adams: You haven't got the letter and the attachments before his Honor. [1221]

Mr. Clark: I have them right here. I will hand them up to your Honor.

Mr. Adams: Your Honor, it seems to me that this is an attempt to argue a matter that has not yet been offered before your Honor.

Mr. Clark: I thought I was asked to read the testimony, your Honor.

Mr. Adams: Not at all. I said if you are going to make a statement about the testimony, the whole testimony should be read, and I take it you are not going to do that. The question before your Honor, I take it, relates to a memorandum prepared by Mr. Polk from which counsel was asking questions of the witness. I suggest that if we are going to go forward with the production of evidence in this

(Testimony of Charles Elsey.)

case, that it be done in the regular way and not by an attempt of counsel in advance to state or read portions of testimony taken upon deposition.

Mr. MacKinnon: I object to it, your Honor, on the ground it is irrelevant and immaterial to any issue in the action. This is just a little bit more of interveners' implications and inferences. If they want to lay the full record before your Honor, let them lay the full record there, but it has nothing to do with the record before you.

Mr. Clark: They are not implications or inferences. They are facts demonstrated by documents and are, in Mr. MacKinnon's words, the current record of what the parties did at the time. Our point is it bears absolutely upon the claim made by these people that up to this time this matter was given the utmost publicity, and therefore, they argue, ergo the interveners or someone should have come in on behalf of this plaintiff corporation and, in one instance, file a claim in bankruptcy, and in the other, start some kind of action or what not. It bears directly upon these technical defenses. I have made my offer of proof, your Honor, and I will take a ruling on it.

The Court: I like to allow anything that is reasonably relevant to the matter, but I do not quite see the point of this.

Mr. Clark: Here is a memorandum, your Honor, made by Mr. Polk concerning these tax transactions, in which he refers to a discussion about setting up a tax reserve in the amount of $7,500,000.

(Testimony of Charles Elsey.)

The Court: There was a tax reserve that was set up, wasn't there?

Mr. Clark: Yes; then he says that is discussed about labeling the $7,500,000 reserve as a reserve for road improvement, not taxes. Now, what is the purpose of that except to keep publicity from the fact that these tax savings are due to this stock loss? There can be no other reason for it. Why should they discuss, if it please the Court, some label such as reserve for road improvement for what ultimately became a tax reserve fund? I propose to show that this witness, although the memorandum by Mr. Polk says that conferences were [1223] had with Mr. Elsey and others, this witness was never present at any conference where there was any such discussion, and when a petition was presented to him labeled "Post-War Modernization" or what not, he refused to go for it.

The Court: Mr. Clark, I understand that, but the fact of the matter is there was a tax reserve set up. They did file returns on this basis. They did take the stock loss. Now, what do the motives with respect to publicity and that sort of thing have to do with this?

Mr. Clark: This bears on a period prior to the setting up of reserves.

The Court: I have my own suspicions as to the nature of these releases and the reason perhaps for not saying too much on the subject, but just covering whatever was necessary. It seems to me,

(Testimony of Charles Elsey.)

at any rate, that that has no particular bearing upon the dispute. What they talked about with respect to labeling this entry does not seem to me to have any bearing upon it. They did take this stock loss as a deduction. They did set up a reserve for taxes in the event they were unsuccessful in establishing it. What has this business about what they said to the public got to do with it? I do not think it has bearing either on the plaintiff's case or on the matter of any special defense either.

Mr. Clark: Very well, your Honor. I will offer for identification—— [1224]

The Court: I would not hold that anyone was bound by what the newspapers put in or what any of these people said about the newspapers.

Mr. Clark: I will offer for identification, your Honor, the documents I passed up to you as Interveners' next exhibit for identification, being a letter addressed to Mr. Elsey under date of February 8, 1944, signed Allen P. Matthew, as Interveners' Exhibit 445-A, -B on deposition, the title being "Reserve Fund for Contingent Tax Liability and for Post-War Modernization and Improvement," and also the form of petition attached thereto and described as Interveners' Exhibit 445-C to -G upon deposition and entitled "Petition for Authority to Establish a Reserve Fund for Contingent Tax Liability and for Post-War Modernization and Improvement."

(The documents referred to were marked Interveners' Exhibit 19 for Identification.)

(Testimony of Charles Elsey.)

Mr. Clark: And in connection with that also I will offer, may it please your Honor, the following testimony by this witness and take a ruling on it. At page 280, line 2, of Mr. Elsey's deposition. I am making an offer of proof.

Mr. Adams: I understand, your Honor, but the witness is here. I believe he should first put the question to the witness and get your Honor's ruling on it.

Mr. Clark: I am making an offer of proof because I understand his Honor is going to sustain an objection to this [1225] line of testimony. That is my reason for marking them for identification. I am perfectly willing to take a ruling on it without further argument.

Mr. Adams: Why is it necessary to read that into the record?

Mr. Clark: I will answer as to my offer to prove, this: Were Mr. Elsey asked why he rejected the petition which has just been marked for identification, he would testify that he knew nothing about the post-war modernization program, and the petition was not satisfactory to him, and that he was not going before Judge St. Sure on any kind of petition except just exactly what it was supposed to be.

Mr. Adams: Of course, your Honor will understand under your Honor's ruling the witness is now on the stand and is not in a position to testify in regard to that matter because of your Honor's rul-

(Testimony of Charles Elsey.)

ing; that Mr. Clark is now reading into evidence testimony, and he read it fairly——

Mr. Clark: I am making an offer of proof and intend to take a ruling on it, which I suspect will be adverse.

The Court: I will overrule the offer of proof, that is, hold that it is not material on the ground that this subject matter is material neither to the plaintiff's nor the interveners' case nor the defense of laches.

Mr. Clark: Yes, your Honor.

Q. Mr. Elsey, referring to these cut-backs you testified to [1226] on your direct examination as having amounted, I think, to date to some two million dollars—is that right?

A. That is correct.

Q. Does that figure include any cut-backs or refunds arising from export shipments?

A. Oh, yes, yes.

Q. Can you tell us approximately what proportion of your approximation of $2,000,000 as having already been deducted by the Government or paid arises from the cut-backs or refunds on export shipments? A. No.

Mr. Phleger: May I point out that the witness has already testified that no calculation or computation was made with respect to this particular matter. He stated that he did not do it.

Mr. Adams: I do not understand counsel's statement. It is rather broad and not very clear to me.

(Testimony of Charles Elsey.)

The Court: The witness has answered the question. He said "No."

Mr. Clark: He can't do it.

Q. Mr. Elsey, I will show you an original letter addressed to Mr. James K. Polk, care of Whitman, Ransom, Coulson & Goetz, 40 Wall Street, New York, dated October 20, 1944, on the letterhead of the Western Pacific Railroad Company and signed by Mr. DeGraff, General Auditor, being Exhibit No. 82 on [1227] deposition, and I will direct your attention particularly to the paragraph commencing at the bottom of page 2, starting, "There is another situation between the railroads and the Government" over to the next page.

Now we will offer this letter in evidence, your Honor. It treats of these cut-backs at the current time.

The Court: For what purpose is it offered?

Mr. Clark: I want to offer it before I examine him on it.

Mr. MacKinnon: I object on the ground it is incompetent, irrelevant and immaterial.

Mr. Clark: I don't need it in evidence.

Q. Let me ask you this, Mr. Elsey: Now, as to any cut-backs or refunds arising from export shipments, am I correct in stating that for the period up to April 1, 1944, the amount of $500,000 in those claims had been determined and settled by refunding $150,000?

A. What is it you want me——

Q. Is that a correct statement?

(Testimony of Charles Elsey.)

A. I don't know. That isn't my letter.

Q. Well, it is the letter of Mr. DeGraff, the general auditor of the company, is it not?

A. Ask Mr. DeGraff; don't ask me.

Q. Well, do you know anything about the subject at all?

A. Not in detail, no. That is an accounting department [1228] matter.

Q. You testified on your direct examination to having known that Mr. Curry was retained by Whitman, Ransom, Coulson & Goetz to do certain work in connection with these tax matters?

A. Yes.

Q. Do you also know, Mr. Elsey, that Mr. Curry's retainer was terminated sometime during the fall of 1948? A. That is correct.

Mr. Adams: Well, the record shows just what the facts are, does it not, Mr. Clark?

Mr. Clark: Well, I haven't the date in mind right now. It was sometime during the fall of '48, and it was to continue until the end of '48.

Mr. Adams: That is right.

Q. (By Mr. Clark): Did Mr. Coulson consult you before terminating Mr. Curry's retainer?

A. No, sir.

Mr. Clark: That is all, your Honor.

Mr. Adams: Your Honor, I have just one or two questions. We could finish, I think.

(Testimony of Charles Elsey.)

Redirect Examination

By Mr. Adams:

Q. Now, Mr. Elsey, in regard to the cut-backs and refunds, Mr. Phleger in one of his questions to you on that subject referred to the matter being involved in book entries, and with counsel's permission I will ask a leading [1229] question at this point: Is it the fact that the way a cut-back operates is that the Comptroller General deducts out of a bill payable to the railroad company the amount of a refund claim that he has previously sent to the railroad company and which refund claim has not been paid by the railroad company?

A. That is correct.

Q. So that there is in that way a reduction in the amount received by the railroad company finally on the transaction to which the cut-back refers?

A. Yes.

Q. Now——

The Court: That is a continuing accounting and bookkeeping procedure, I take it?

Q. (By Mr. Adams): Is that right, Mr. Elsey?

A. That is correct.

Q. Now, you were asked also upon cross-examination whether or not the amount of cut-backs and refunds on war traffic was still in dispute between the company and the office of the Comptroller General? A. That is correct.

Q. Now, in answering that question did you have reference to the approximate $2,000,000 of

(Testimony of Charles Elsey.)

cut-backs that you know about definitely, as well as to figures in addition to that?

Mr. Phleger: Well, I object to that as a leading question.

Mr. Adams: It is leading. [1230]

Mr. Phleger: And improper redirect examination.

Mr. Adams: The question was raised as to the amounts in dispute, and I want to find out whether the $2,000,000 figure includes disputed amounts or whether the disputes relate to the additional claims outside of the $2,000,000 figure. I don't think that I have led the witness to any answer, and I am interested in finding out.

Mr. Phleger: Well, he has testified that he hasn't made any computations and that none had been, no segregation made.

Mr. Adams: It may be the witness will answer my question in the negative. I don't know the answer. I would like to ask the question.

The Court: See if you cannot ask it in such a form that it isn't leading, Mr. Adams.

Q. (By Mr. Adams): You were asked, Mr. Mr. Elsey, upon your cross-examination questions in respect of disputes still going on between the railroad company and the Government?

A. Yes.

Q. Regarding these cut-backs and refunds?

A. Yes.

Q. Now, can you tell me whether or not such

(Testimony of Charles Elsey.)

disputes are going on as to that portion of the cut-backs and refunds which have been definitely ascertained by the railroad company?

A. The cut-backs that I mentioned in the approximate figure of $2,000,000 are cut-backs that we have agreed to. The [1231] Government has also made cut-backs in addition to this $2,000,000 that we don't go along with; and those matters are still under correspondence.

Mr. Adams: I have no further questions, your Honor.

Recross-Examination

By Mr. Phleger:

Q. What were the years? You have referred to $2,000,000. What years were those cut-backs for?

A. In what year the shipment was handled?

Q. Yes. A. I haven't got the least idea.

Mr. Phleger: That is all.

Mr. Clark: Ask him to segregate it.

Mr. Phleger: No, I don't want him to segregate it. That is all. [1232]

* * *